The Senate

Economics
Legislation Committee

Carbon Pollution Reduction Scheme Bill 2009 and related bills [Provisions]

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Senate Economics Legislation Committee

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TABLE OF CONTENTS

Chapter 1
Introduction and conduct of the inquiry

The Carbon Pollution Reduction Scheme

1.1 The Carbon Pollution Reduction Scheme (CPRS) is the cap-and-trade emissions trading scheme designed as Australia's contribution to limiting the global emissions of greenhouse gases so as to contain global warming and climate change.

1.2 The CPRS is the result of a long process of analysis and consultation by successive federal parliaments and governments. A Senate Committee started examining the issue over two decades ago. Its report in 1991 concluded:

> …the Committee supports concerted action to reduce greenhouse gas emissions…a target of 20% reductions by 2005…it is now time for action. That action must be speedy and must be a practical solution in the short term. Setting up committees to further examine greenhouse issues or putting out press releases imploring the community to be more energy conscious does not constitute action that will result in sufficiently significant reductions of greenhouse gas emissions.[1]

1.3 Australia first undertook to take action in this area when it ratified the United Nations Framework Convention on Climate Change in 1992. Australia was heavily involved in negotiating the Kyoto Protocol to the Convention in 1997 (although it did not ratify it until 2007). In 1998 the Australian Greenhouse Office was established. The *Shergold Report* (Prime Ministerial Task Group on Emissions Trading) in May 2007 recommended that an emission trading scheme should be implemented in Australia, as did the *Garnaut Review* in September 2008. The current government released *Green* and *White Papers* on the scheme. Exposure drafts of the bills to introduce the CPRS were released in March 2009.

The Economics Committee inquiry

1.4 The Senate referred the exposure drafts of the CPRS to the Standing Committee on Economics on 11 March 2009 and the Committee reported on 16 April 2009.

1.5 The Committee was unanimous in regarding the risk of climate change as deserving a serious response. The majority of the Committee called for the Senate to approve the CPRS.[2] While the Coalition senators rejected the specific CPRS, they too

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1 Senate Standing Committee on Industry, Science and Technology, *Rescue the Future: reducing the impact of the greenhouse effect*, January 1991. The Senate had referred the matter to the committee in November 1988.

2 Senate Standing Committee on Economics, *Exposure draft of the legislation to implement the Carbon Pollution Reduction Scheme*, April 2009 (hereafter *CPRS ED Report*), p 19.

believed 'the planet deserves the benefit of the doubt. It is in the planet's and Australia's interests to reduce the world's, and Australia's, carbon dioxide emissions'.[3] Senator Xenophon stated 'there is a sensible policy case, as well as a strong ethical one, for Australia to take early emissions reduction action…'.[4] The Australian Greens called for a stronger response than the CPRS.[5]

1.6 There were a number of aspects of the CPRS which submissions and witnesses suggested could be improved, and suggestions for accompanying action. These opinions were discussed in the report and to varying degrees supported by Committee members.

1.7 On the issue of voluntary action by households, the Committee commented:

> People want to feel that they are making a contribution, even if only in a small way, to saving the planet. The growing perception that the CPRS negates actions taken by individual households to reduce emissions is eroding support for the scheme. This must be addressed.[6]

1.8 Accordingly the Committee recommended that:

> …the government develop policies complementary to the CPRS to encourage voluntary action…the wording of section 14(5) of the CPRS Bill 2009 be amended so that in making recommendations on emissions caps the Minister "shall have regard" rather than "may have regard" to "voluntary action".[7]

1.9 On the issue of employment, the Committee recommended that:

> … the Government coordinates and advances a whole of government approach to jobs and skills in emerging low pollution industries. The Committee further recommends that a process be developed which ensures effective implementation of all Government programs and policies which support green jobs and skill development throughout all sectors of the economy. The Government should also develop Australia's current and future skills base to ensure it has sufficient skills to take advantage of emerging employment opportunities driven though the CPRS and other complementary climate change policies.[8]

1.10 On the issue of the emissions reductions target, the Committee noted that while some witnesses regarded the targets of a 5-15 per cent reduction in greenhouse gas emissions from 2000 to 2020 as ambitious, others argued that Australia should

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3 *CPRS ED Report*, p 125.

4 *CPRS ED Report*, p 147.

5 *CPRS ED Report*, p 159.

6 *CPRS ED Report*, p 73. A similar point is made in the Coalition senators' dissenting report, which argued 'many people…would be greatly discouraged if the proposed CPRS disempowered them, allowing for emitters to benefit from their voluntary actions rather than the environment'; *CPRS ED Report*, p 132.

7 *CPRS ED Report*, pp 73-4.

8 *CPRS ED Report*, p 63.

offer a larger reduction as part of a global agreement to stabilise atmospheric concentrations at around 450 parts per million (CO_2 equivalents).[9]

1.11 On the issue of assistance to emissions-intensive, trade-exposed industries, the Committee noted:

> Payments of assistance can be justified to guard against carbon leakage and support emission intensive trade exposed industries during the transition…The Committee notes the persistent advocacy of industry groups for further assistance under the scheme.[10]

1.12 On the issue of the timing of the scheme's introduction, the Committee noted that there were:

> …a variety of views about whether the CPRS should be introduced soon or delayed; and whether the legislation itself should be delayed or just the starting date.[11]

1.13 The Committee believed the importance of providing certainty for business and the need to present a clear position at the Copenhagen conference in December 2009 justified passing the legislation this year, regardless of the starting date.[12]

The Government's response to comments about the CPRS

1.14 In response to these reactions to the exposure draft of the CPRS legislation, the Government announced a number of changes, mostly on 4 May. These changes have been embedded in the CPRS bills. The main changes are:

- an increase in the conditional target for emissions reductions to a 25 per cent reduction from 2000 to 2020;
- a 'global recession buffer' of additional transitional assistance for emissions-intensive trade-exposed industries;
- changed treatment of 'legacy emissions' for landfill operators;
- recognition of household purchases of Green Power in the setting of targets;
- other recognition of households' voluntary emissions reductions;
- deferral of the operation of the scheme until July 2011; and
- a fixed permit price of $10 a tonne for the first year of operation.

1.15 The CPRS package is essentially self-funding over the next four years. Table 1.1 shows how the potential revenue from the sale of permits is distributed to households and (including by allocation of free permits) to businesses.

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9 *CPRS ED Report*, pp 35-40.

10 *CPRS ED Report*, pp 49 and 58.

11 *CPRS ED Report*, p 9.

12 *CPRS ED Report*, pp 9 and 19.

Table 1.1: Fiscal impact of CPRS package

($ billion)

	2009-10	2010-11	2011-12	2012-13
Potential revenue from permit sales	0	0	4.5	13.0
Assistance for households	0	0	-1.5	-5.1
Fuel tax offsets	0	0	-0.9	-2.2
EITEs assistance (free permits)	0	0	-1.2	-3.6
Other payments to industry	0	0	-1.5	-4.3
Climate change action fund	-0.2	-0.3	-0.7	-0.6
Total impact on budget	-0.2	-0.3	-0.1	0.8

Source: *CPRS Amendment (Household Assistance) Bill 2009 Explanatory Memorandum*, p. ii.

The conduct of the current inquiry

1.16 The Senate referred the CPRS bills to the Economics Legislation Committee on 14 May and required the Committee to report by Monday 15 June 2009.

1.17 There are eleven bills in the total package:

- Carbon Pollution Reduction Scheme Bill 2009 (the primary bill);
- Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009;
- Australian Climate Change Regulatory Authority Bill 2009;
- Carbon Pollution Reduction Scheme (Charges – Custom) Bill 2009, Carbon Pollution Reduction Scheme (Charges – Excise) Bill 2009 and Carbon Pollution Reduction Scheme (Charges – General) Bill 2009;
- Excise Tariff Amendment (Carbon Pollution Reduction Scheme) Bill 2009 and Excise Tariff Amendment (Carbon Pollution Reduction Scheme) Bill 2009;
- Carbon Pollution Reduction Scheme (CPRS Fuel Credits) Bill 2009 and Carbon Pollution Reduction Scheme (CPRS Fuel Credits) (Consequential Amendments) Bill 2009; and the
- Carbon Pollution Reduction Scheme (Household Assistance) Bill 2009, which was introduced into the house on 28 May.

1.18 As there had been an extensive report on the exposure drafts, the Committee decided that this report would concentrate on the changes made since the exposure drafts.

1.19 The Committee advertised the inquiry in the national press and invited written submissions by 4 June 2009. Details of the inquiry were placed on the Committee's

website and the Committee also wrote to a large number of organisations and stakeholder groups inviting written submissions.

1.20 As this was the fourth Senate committee inquiry into the issue of climate change and the CPRS in recent months,[13] it was unsurprising that it received fewer submissions. However the 48 submissions received is well above the median number for a senate committee inquiry. The submissions are listed in Appendix 1.

1.21 Two public hearings were held in Canberra on 22 and 29 May 2009. A list of the witnesses appearing at the hearings is in Appendix 2. These two hearings concentrated on peak industry, environmental and social organisations and the relevant government departments as these were better placed to focus on the changes since the exposure draft. A representative from the landfill industry was called as there had been specific changes pertaining to the treatment of this industry announced since the exposure draft.

1.22 Half the senators on this Committee are also members of the Select Committee on Climate Policy and participated in its hearing on the changes to the CPRS exposure draft at which evidence was taken from further industry, environmental and social organisations and a number of individual companies. In addition, the views of many companies on the CPRS were canvassed during the extensive hearings into the CPRS exposure drafts.

1.23 The Committee thanks those who participated in this inquiry.

Structure of the report

1.24 There are four main areas where the CPRS bills differ from the exposure drafts, and each is allocated a chapter. Chapter 2 discusses the higher conditional target for emissions reductions. The responses to concerns expressed by business, notably the increased number of free permits, is the subject of Chapter 3. The recognition of voluntary action is the topic of Chapter 4. The deferral of the operation of the scheme in light of the global economic crisis is the topic of Chapter 5. Chapter 6 concludes.

13 The Senate Standing Committee on Economics tabled a report on 16 April 2009 and the Senate Select Committee on Fuel and Energy tabled a report on 7 May 2009. The Senate Select Committee on Climate Policy is reporting on 15 June 2009, and has received over 8,000 submissions.

Chapter 2
The higher conditional target

The higher target

2.1 The Government has raised the maximum emissions reduction it will place on the table at Copenhagen from 15 per cent to 25 per cent. The Government explained that international developments since December 2008 have improved the prospects of a more ambitious global agreement.[1]

2.2 Having a 25 per cent upper limit on the table meets a key demand of a number of witnesses and submitters:

> …put back on the table the condition of 25 per cent reduction of emissions by 2020. The government has done that, so my assessment is that it now would be clearly a positive for this bill to be passed into law.[2]
>
> We welcome the Government's decision to include up to a 25 percent reduction target in greenhouse gas emissions…this will help to unlock Australian negotiators from the inadequate previous 5-15 percent emissions reductions targets and enable Australia to actively and positively participate in the international climate change negotiations in Copenhagen.[3]
>
> …the government actually got the national interest test roughly right in that a national interest is an agreement that gets us towards 450 ppm or lower. The problem with the previous *White Paper* was that their targets did not represent their fair share towards that goal. It was very significant to us that we went to that 25 per cent target.[4]
>
> …recent revisions to the CPRS mean that more environmentally acceptable targets are now part of Australia's position going into international negotiations in Copenhagen later this year. I heartily endorse this move…[5]
>
> A target of 25 per cent boosts Australia's credibility and ability to push for a strong international agreement. The stronger target moves Australia from being an international climate laggard into a position that could help negotiate a successful outcome.[6]

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1 Department of Climate Change Fact Sheet, *Strengthening Australia's 2020 Carbon Pollution Target*, p 1.

2 Professor Ross Garnaut, *Proof Committee Hansard*, 22 May 2009, p 18.

3 Uniting Justice Australia, *Submission 5*, p 1.

4 Mr John Connor, Chief Executive Officer, Climate Institute, *Proof Committee Hansard*, 29 May 2009, p 53.

5 Mr Iain Murchland, *Submission 9*, p 1.

6 Mr Owen Pascoe, Australian Conservation Foundation, *Proof Committee Hansard*, 29 May 2009, p 68.

> We welcome the decision of the government and the opposition to support a much higher target…An international agreement that is effective will not emerge unless countries such as Australia offer to make very deep reductions indeed. Twenty-five per cent represents a good step on the road to those deep reductions. While wealthy countries, such as Australia, are not willing to commit to deep reductions in the medium and long term, an international agreement that is effective will not emerge.[7]

2.3 On the other hand, having a potential target of this magnitude could trouble those who had regarded even 5 per cent as a difficult target:

> …the unconditional offer is a target of five per cent below 2000 levels by 2020. That is what the current proposal is. We think that is a very big ask. That is an ask of stripping one in five emissions out of our economy, relative to business as usual, by 2020. We think that is a very big ask.[8]

> …the minus five per cent target, which represents a 25 per cent reduction in emissions relative to expected trends and a 34 per cent reduction relative to per capita emissions, is some three to four times stronger than those proposed by other, wealthier countries such as the USA and countries of the EU, as measured by an impact on gross national product. AIGN advocates that Australians shoulder a fair share of the global burden—no more and no less.[9]

2.4 The Australian Industry Greenhouse Network claims the Australian offer of a 25 per cent reduction is very onerous (without explaining the basis for their calculations):

> AIGN would note that if Australia took on commitments as high as -25% of 2000 emissions by 2020, comparable commitments by the EU would likely need to be well over -50%, by the USA around -40% and by China to return to 2000 level emissions by 2020.[10]

2.5 The 25 per cent reduction refers to 2020 emissions relative to 2000 emissions. As there was little increase in emissions from 1990 to 2000 in Australia, this represents a similar increase over the 1990 base year relative to which most other countries are expressing their targets. As Australia's population is growing faster than most advanced economies, it represents a comparable percentage reduction in per capita emissions to other advanced economies which have announced targets. However it would still leave Australia's per capita emissions above those of most other advanced economies and well above those of the rest of the world.

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7 Mr Paul Toni, World Wildlife Fund, *Proof Committee Hansard*, 29 May 2009, p 62.

8 Dr Peter Burn, Australian Industry Group, *Proof Standing Committee on Economics Hansard*, 27 March 2009, p 78.

9 Mr Michael Hitchens, Australian Industry Greenhouse Network, *Proof Select Committee on Climate Policy Hansard*, 15 April 2009, p 21.

10 Australian Industry Greenhouse Network, *Submission 39*, p 4.

2.6 Australia's offer is compared to that of other economies in Table 2.1, which attempts to express the various plans on a common 1990 base. For example, the US 2009 Budget proposes a 14 per cent reduction in emissions by 2020 but, as this is from 2005 levels, it represents only about a return to 1990 levels. The table uses United Nations population projections to express the targets in per capita terms; in some cases (including Australia) these projections differ from those of national governments. Another reason the table should only be regarded as indicative rather than definitive is that different sources give differing estimates of historical emissions.

Table 2.1: Comparison of emission reduction targets for 2020

Targets and proposals	% change from 1990	% change from 1990 per capita	per capita emissions (tonnes of CO_2e)
Australia	-3 to -24	-30 to -45	15 to 12
European Union	-20 to -30	-25 to -34	8 to 7
United Kingdom	-34	-42	7
US (2009 budget proposal)	-1	-27	11
US (Waxman bill[11])	-4	-29	11
Canada (Government target)	+24	-8	12
Canada (House bill C-311[12])	-25	-44	7
Germany	-40	-41	9
Netherlands	-30	-39	8
Norway	-30	-43	4
Switzerland	-20 to -30	-32 to -40	4

Sources: Secretariat calculations based on *White Paper*, p 3-3; *Garnaut Report*, p 177; Department of Climate Change Fact Sheet – Emissions, target and global goal; 'Economic cost as an indicator for comparable effort'; 'A new era of responsibility: renewing America's promise' (US 2009 Budget), p 21; *UK Budget 2009: Building a low-carbon economy- implementing the Climate Change Act 2008.* Per capita percentage changes are calculated from the previous column based on population projections in United Nations, *World Population Prospects* and then the numbers in the final column calculated by applying these per capita percentage changes to 1990 per capita emissions (including land use change and forestry) from the United Nations Framework Convention on Climate Change; http://esa.un.org/unpp.

11 The Waxman-Markey bill has been approved (by 33-25) by the House of Representatives Energy and Commerce committee, and has now been forwarded to other committees.

12 The bill has passed a second reading vote and is now before a parliamentary committee.

The conditions for the 25 per cent reduction

2.7 The proposed Australian offer is subject to the world agreeing to an ambitious global deal to stabilise levels of CO_2e at 450 ppm or lower. There are a number of conditions the Government has outlined as being necessary to reach a 450 ppm agreement. These are:

> 1. comprehensive coverage of gases, sources and sectors, with inclusion of forests (e.g. Reducing Emissions from Deforestation and forest Degradation - REDD) and the land sector (including soil carbon initiatives (e.g. bio char) if scientifically demonstrated) in the agreement;
>
> 2. a clear global trajectory, where the sum of all economies' commitments is consistent with 450 ppm CO_2-e or lower, and with a nominated early deadline year for peak global emissions no later than 2020;
>
> 3. advanced economy reductions, in aggregate, of at least 25 per cent below 1990 levels by 2020;
>
> 4. major developing economy commitments to slow growth and then reduce their absolute level of emissions over time, with a collective reduction of at least 20 per cent below business-as-usual by 2020 and a nominated peak year for individual major developing economies;
>
> 5. global action which mobilises greater financial resources, including from major developing economies, and results in fully functional global carbon markets.[13]

2.8 Some of the individual criteria are discussed in turn in the following sub-sections. Some peak business and environmental bodies are broadly supportive of them:

> The BCA has supported the conditions that are there for the transition to the minus 25 and the independent review to check that those conditions are met. From our point of view, making sure all those commitments are met and using that independent review to do that remains important—is essential… If the commitments that are in the shift from the minus five to the minus 25 are evidenced…then we would not be disadvantaged.[14]
>
> It is important to comment about the conditions connected to the 25 per cent. We do think that is a fair reflection of the sorts of conditions that we are going to need to get to 450 ppm or lower. It is a tough challenge and it will require a peaking of emissions before 2020.[15]

13 Department of Climate Change Fact Sheet, *Strengthening Australia's 2020 Carbon Pollution Target*, p 1.

14 Ms Maria Tarrant, Business Council of Australia, *Proof Committee Hansard*, 22 May 2009, p 25.

15 Mr John Connor, Climate Institute, *Proof Committee Hansard*, 29 May 2009, p 53.

Comprehensive coverage

2.9 The Department of Climate Change explained:

> The point about the inclusion of forests, particularly reducing and avoiding deforestation, is that they contribute around 20 per cent of global emissions at the moment. So, to really do something consistent with the 450 parts per million agreement, it would be necessary to have coverage of those sectors and some reduction activities.[16]

Cuts in developing country emissions

2.10 It is broadly recognised that in order to meet the 450 parts per million agreement a global solution will be required. Whilst recognising it is the responsibility of advanced economies to take action earlier, it is essential that major developing economies also contribute to reducing emissions over time.

2.11 Uniting Justice expressed some concerns:

> We are concerned, however, about the requirement that an Australian emissions reduction target of 25 percent be conditional on a international agreement which contains 'major developing economy commitments to slow growth and to then reduce their absolute level of emissions over time, with a collective reduction of at least 20% below business-as-usual by 2020'. We would wish to see more detail as to which countries will be classified as a 'major developing economy', and have concerns about the current lack of funding and technology transfer to developing countries to assist with climate change mitigation and adaptation.[17]

Fully functional global carbon market

2.12 The Department of Climate Change explained:

> There would also have to be a 'full range of international abatement opportunities through a broad and functioning international market in carbon credits'. The idea essentially is that, for us to reach a 450 parts per million agreement, there is going to have to be very concerted global action, but also Australia is going to need to access some international abatement; otherwise, the domestic costs of seeking purely domestic abatement may be too high.[18]

2.13 The Government has stated its policy that if the Copenhagen agreement allows it, up to five percentage points of the -25 per cent target could be met by buying international Kyoto units with the revenue for auctioning permits.[19]

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16 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p 6.

17 Uniting Justice Australia, *Submission 5*, p 1.

18 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p 6.

19 *CPRS Bill, Explanatory Memorandum*, p 81.

Assessing whether the conditions are met

2.14 An independent review panel will assess whether the conditions for adopting the 25 per cent reduction target have been met. The panel will include relevant scientific and economic expertise and will conduct public hearings. Its report will be tabled in parliament.[20]

Reflecting the targets in annual caps

2.15 The targets will be translated into annual caps on the issue of emissions 'permits' (or 'Australian emissions units' to use the technical term) in regulations. The caps will be for a lower amount of emissions than the target quantity as some sectors (such as agriculture) are outside the CPRS and some emitters fall below the threshold for participation in the scheme (generally 25,000 tonnes of CO_2e per year).

2.16 The bill requires the Minister to take 'all reasonable steps' to set annual caps up to 2014-15 by July 2010 and caps for all subsequent years at least five years in advance.[21] This acknowledges that a Minister cannot guarantee that regulations will not be disallowed. If a cap is not set by a regulation, the default position is that the cap for a given year is 1 per cent lower than that for the previous year, as long as this does not put the cap outside the boundaries of the applicable gateway.[22]

2.17 In setting caps in the regulations, the Minister 'must take all reasonable steps' to ensure the cap is within the applicable gateways.[23] 'Gateways' are ranges which may be set for years after 2015. There are no restrictions on their width, so they could be used to set a maximum but not a minimum for future years if this was desired.

The lower targets

2.18 The unconditional target remains at a 5 per cent reduction. The previously stated 15 per cent reduction may be applied if there is agreement on significant global cuts in emissions at Copenhagen but they do not meet the criteria above for the 25 per cent reduction.

2.19 Even the 5 and 15 per cent reductions by 2020 still involves Australia being on a trajectory towards a 25 per cent (and more) reduction. In the case of a 15 per cent reduction by 2020, emissions are projected to reach the 25 per cent reduction mark by 2024. In the case of a 5 per cent reduction by 2020, emissions are projected to reach the 25 per cent reduction mark by 2034.[24]

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20 *CPRS Bill*, *Explanatory Memorandum*, p 16.

21 *CPRS Bill*, sections 14(2) and 14(3).

22 *CPRS Bill*, section 14(4).

23 *CPRS Bill*, section 15.

24 Prime Minister, Treasurer and Minister for Climate Change and Water, 'New measures for the carbon pollution reduction scheme', Media Release, 4 May 2009.

Chapter 3

Response to business concerns

3.1 The bills introduced into Parliament on 14 May 2009 include a number of changes which were made in response to industry representations. This chapter looks at some of these major changes, including the additional allocation of permits to trade exposed industries via the 'global recession buffer', changes to treatment of landfill, and changes made to reviews of assistance.

3.2 Further discussion of the impact of the Global Financial Crisis, and the delays in the commencement of the scheme arising from it, is provided in Chapter 5.

EITE assistance and the global recession buffer

3.3 In his second reading speech on introduction of the CPRS Bill, the Parliamentary Secretary for Climate Change, the Hon Greg Combet MP, provided the following explanation for providing assistance for companies in the Emissions-Intensive Trade-Exposed (EITE) category, and for providing additional assistance in the form of the global recession buffer:

> Free emissions permits will be issued to our emissions-intensive trade-exposed industries to reduce the risk of 'carbon leakage'. Carbon leakage occurs when industries move from Australia to elsewhere, with no benefit in terms of global emissions reductions, upon introduction of a carbon price in Australia. This risk occurs when Australia imposes a carbon price on our trade-exposed industries ahead of competitor economies. Transitional industry assistance is designed to reduce this risk. Regulations will provide the detail of eligible industries and rates of assistance, but the key parameters have been elaborated in significant detail in the white paper and the Prime Minister's announcement of 4 May 2009.
>
> As announced on 4 May 2009, a global recession buffer will be provided for emissions-intensive trade-exposed industries for the first five years of the scheme, in addition to previously announced rates of assistance.
>
> This buffer will provide an additional five per cent free permits for EITE activities eligible for 90 per cent assistance, giving an effective rate of assistance of almost 95 per cent to these highly emissions-intensive trade-exposed activities in the first year of the scheme.
>
> The buffer will provide an additional 10 per cent free permits for EITE activities eligible for 60 per cent assistance, giving an effective rate of assistance of 66 per cent to these moderately emissions-intensive trade-exposed activities in the first year of the scheme.

> Rates of assistance will decline at a rate of 1.3 per cent per year, in line with the carbon productivity contribution set out in the government's white paper.[1]

3.4 Some economists regarded the timing of this assistance as inconsistent with the Government's own macroeconomic forecasts:

> The five per cent recession buffer is interesting given that the government is forecasting 4.5 per cent growth in its budget over the same timeframe.[2]

3.5 Provisions concerning EITE assistance can be found in Part 8 of the CPRS Bill. The detail of the EITE programme will be contained in regulations. The Department of Climate Change is currently engaged in a process with industry of identifying industry activities which will be eligible for assistance under the EITE programme.[3]

3.6 The Department of Climate Change has indicated that the 'primary reason' for the increased allocation of free permits was the global recession.[4] The Global Recession Buffer is expected to cost an additional $1 billion over five years, with assistance rising from $70 million in 2011-12 (the time at which the cost of permits will be capped to $10) to $290 million in 2015-16.[5] This comes in addition to previously announced assistance provided to industry under the EITE programme.

Carbon Leakage – economic arguments

3.7 The committee heard a diverse range of views concerning the true extent of likely 'carbon leakage' after implementation of the scheme, and the necessity for increasing the level of assistance already announced in the *White Paper*.

3.8 The Productivity Commission has acknowledged that there is an 'in-principle' argument in favour of providing assistance to emissions intensive trade exposed industries, but that judging the correct level of assistance presents difficulties:

> In practice, determining the level of assistance to EITE activities is complicated by uncertainty about the extent of carbon leakage. A global

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1 Hon Greg Combet MP, Parliamentary Secretary for Climate Change, *Proof House of Representatives Hansard*, 14 May 2009, pp 10-11.

2 Mr Salim Mazouz, Director, EcoPerspectives, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 45.

3 Senator the Hon Penny Wong, Media Release PW 86/09, 'Defining emissions intensive industries under the Carbon Pollution Reduction Scheme, 1 April 2009, http://www.environment.gov.au/minister/wong/2009/mr20090401.html, viewed 1 June 2009.

4 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 7.

5 Styles, Jule & Talberg, Anita, Parliamentary Library Briefing Note, 'Budget 2009-10: Climate Change and Energy', http://www.aph.gov.au/library/pubs/RP/BudgetReview2009-10/Climate_Energy.htm, viewed 1 June 2009.

> carbon constraint would help abatement activities shift to where they impose the lowest costs. However, if Australia imposes a constraint ahead of other countries, production may shift to countries not because of cheaper abatement opportunities, but because firms in those countries do not pay the full price of their pollution. So, judging the extent of carbon leakage requires estimating a counter-factual: what activities would stay in Australia in the environment of a uniform and consistent global carbon constraint?
>
> Accordingly, identifying activities that may contract, shut-down or shift offshore following the introduction of a domestic constraint is not sufficient. The test for carbon leakage is whether these shifts would still have occurred even if other countries efficiently constrained their carbon usage. The difficulty in forming these judgements make it likely that any policy response will at times fail to protect against carbon leakage and also at times provide assistance where no carbon leakage would have otherwise occurred.[6]

3.9 Many organisations characterised 'carbon leakage' as a significant threat. Dr Brian Fisher provided the following example:

> There is no doubt that, if you are faced with a regime that taxes methane—which, as a greenhouse gas, is 21 times more potent than carbon dioxide—at the rate that is potentially suggested, there is no doubt that any gaseous mine will become less competitive; and it will become potentially radically less competitive than mines, for example, in Indonesia. As a consequence of that, jobs will be lost from those mines in Australia.[7]

3.10 Similar concerns were expressed by Dr Moran of the Institute of Public Affairs:

> If the major users of energy have to incur a cost or a doubling of the price of the energy—even if energy is 20 per cent, and it is rather more than that in the case of aluminium—then they would not be competitive and they would move offshore. Even quite small changes in price do cause firms to move offshore, as we are seeing in terms of all the globalisation debates of industries like Adidas, Puma and organisations like that moving where they manufacture their shoes from one country, Indonesia, to Vietnam et cetera on the basis of quite small changes in costs. That is the sort of reality of the world economy as it is now.[8]

3.11 Many other economists take the view that the concerns about carbon leakage are exaggerated and/or that the assistance in the CPRS is more than enough to prevent it. The author of the *Stern Review* recently wrote:

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6 Productivity Commission, *Trade Assistance Review 2007-08*, 27 May 2009, p. 109. This is a similar view to that put in R Garnaut, *The Garnaut Climate Change Review*, 2008, (hereafter *Garnaut Review*).

7 Dr Brian Fisher, *Proof Committee Hansard*, 29 May 2009, p 44.

8 Dr Alan Moran, *Proof Committee Hansard*, 22 May 2009, p. 30.

> …the evidence from studies of the mobility of firms in response to environmental policies is that it is negligible.[9]

3.12 Mr Richard Denniss of the Australia Institute has argued:

> I think the risk of carbon leakage is overstated. We have to ask ourselves: where was all the exchange rate leakage when the exchange rate was US$0.90? The fact is that a lot of mobile capital stayed put—and for good reason. And carbon leakage is not the only risk that Australia faces, from an economic point of view. It is certainly not the only risk that big investors face.[10]

3.13 This view was also strongly expressed to the committee by environmental groups:

> …the emissions trading assistance is in excess of what is genuinely needed in terms of the threats…[11]

> …the claims made are overexaggerated, that the risk of so-called carbon leakage is overstated…[12]

> I think that the claims that are being made by industry are very exaggerated. I find it extraordinary that so many major corporations, who have been on notice for a very long time and have been preparing for this for a very long time, can claim that they will not be able to innovate to deal with this.[13]

3.14 The potential for permit allocation under the EITE assistance programme to exceed actual emissions for some companies was tacitly acknowledged by the Department of Climate Change:

> The other point to make is that the basis of that assistance is provided on 2007-2008 intensity baselines. To the extent that industries have been able to improve their emissions intensity efficiency over the period to the commencement of the scheme, that does not reduce the amount of assistance provided but does reduce their liability under the scheme. So the level of actual liability for the most emissions intensive firms is significantly reduced by the emissions-intensive trade-exposed assistance and moves it to a level that is relatively small compared with the overall costs.[14]

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9 Sir Nicholas Stern, *A Blueprint for a Safer Planet*, 2009, p 164.

10 Dr Richard Denniss, Executive Director, The Australia Institute, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 51.

11 Mr John Connor, Climate Institute, *Proof Committee Hansard*, 29 May 2009, p 59.

12 Mr Owen Pascoe, Australian Conservation Foundation, *Proof Committee Hansard*, 29 May 2009, p 72.

13 Mr Paul Toni, World Wildlife Fund, *Proof Committee Hansard*, 29 May 2009, p. 64.

14 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 5.

Committee View

3.15 In its inquiry into the exposure drafts of the carbon pollution reduction scheme legislation, the Standing Committee on Economics found that carbon leakage was a matter of genuine concern:

> The Committee regards carbon leakage and the need to smooth the adjustment process to a low-carbon economy as good reason for some government assistance to industry…The CPRS structures these assistance measures in a manner that retains incentives to take measures to reduce emissions of greenhouse gases.
>
> The committee notes the persistent advocacy of industry groups for further assistance under the scheme. On the other hand other stakeholders have criticised the scheme for being too generous to polluting industries.
>
> The committee believes that the Bill has the balance right, retaining strong incentives to reduce carbon intensity while enabling important economic assets to remain viable throughout the adjustment. This is fundamentally important to protecting jobs and enabling jobs in the green economy to grow.[15]

3.16 The committee remains satisfied that carbon leakage is a legitimate concern, and that there are strong arguments in favour of providing transitional assistance to trade-exposed industries. The committee sees no virtue in the elimination of an emissions intensive industry in Australia (and consequent loss of jobs) if that industry simply relocates to another jurisdiction where it is allowed to pollute more heavily. Such a scenario would lead to no net gain in terms of global emissions reductions. Ideally, however, assistance to these industries should continue only until industries on competitor countries face a similar emissions constraint.

Free permits versus auctioning

3.17 The Government intends that, after a period of transition, all permits will be auctioned. This is consistent with the fundamental idea that the CPRS is correcting the problem that CO_2 emissions (like all other forms of pollution) will be too high if those responsible for them do not bear the resulting cost:

> …auctioning permits ensures that the entities who are responsible for high levels of emissions are the ones that pay for the environmental costs (consistent with the 'polluter pays' principle).[16]
>
> The Carbon Pollution Reduction Scheme will build a low-pollution economy of the future for Australia. Under the Scheme, Australia's biggest polluters will pay for the pollution they generate…[17]

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15 *CPRS ED Report*, p. 70.

16 *Carbon Pollution Reduction Scheme: Australia's Low Pollution Future*, December 2008 (hereafter *White Paper*), p 9-4.

3.18 However, auctioning was criticised by some industry representatives. The Minerals Council of Australia (MCA) cited some economic literature that holds that there is little difference in terms of environmental impact as to whether permits are auctioned or allocated by other means.[18] Dr Brian Fisher (in his capacity as Chief Executive Officer, Concept Economics, which provided consultancy services for the MCA) argued that auctioning of permits from commencement were not necessary to drive environmental benefits:

> This issue is being debated long and hard. The reason that most economists put that point of view is simply that, whether or not the permit is given to you, you still face the same opportunity cost; basically, your costs as an operator are still the same. Whether you are transferred a permit is a matter of an income transfer; it is not an efficiency question. As a consequence of that, the vast majority of the literature on this matter says that it makes no difference.[19]

3.19 Because it argues there is little *environmental* impact from free allocation of permits, the MCA asserted that there is no justification for the additional *economic* impacts it argues arise from imposing auctioning of permits on their industry. Mr Hooke expressed the opinion that auctioning permits from commencement of the scheme was the 'essential and fundamental flaw' in the CPRS.[20]

3.20 There are three main problems with the MCA argument. Firstly, *even if* giving the mining sector free permits still retains an incentive to reduce emissions, this is not an argument for making such a large income transfer to the mining sector anymore than it is an argument for making a large income transfer to any other sector.[21] Such a transfer to the mining sector has to be justified on some public policy grounds such as the above argument on carbon leakage, which then implies it is appropriate that the transfer be limited in time and coverage.[22]

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17 Australian Government, *The Carbon Pollution Reduction Scheme and You*, 2008.

18 The MCA gave the example of Eileen Claussen of the Pew Centre on Global Climate Change in this context.

19 Dr Brian Fisher, Chief Executive Officer, Concept Economics, *Proof Committee Hansard*, 29 May 2009, p. 45.

20 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, 29 May 2009, p. 34.

21 As Sir Nicholas Stern puts it, 'auctioning is superior to free allocations…it raises revenue for the government. Giving away that revenue as transfers to firms through free allowances would be a peculiar and inegalitarian use of public money'; *A Blueprint for a Safer Planet*, 2009, p 108.

22 As Stern comments, 'The argument for temporarily free allocations, or for phasing in the auctioning of permits – that they help with the adjustment process…has more substance'; *A Blueprint for a Safer Planet*, 2009, p 108.

3.21 Secondly, it is not uncontested that the environmental impact from giving permits to large polluters will always the same as under auctioning. As argued in the *White Paper*:

> In practice, because administrative allocations will be made for reasons other than pure efficiency, the initial allocation of permits will not be made to the highest valuing users. Firms will be able to trade permits in the secondary market, but trading costs and information issues mean that this will not be costless. Furthermore, international experience suggests that where permits are issued for free there may initially be some inefficient hoarding by the recipients.[23]

3.22 This view is supported by the author of the *Stern Review*:

> …auctioning can hasten adjustment. The longer allocations are given free, the less pressure there is on firms to move quickly. It is true that the marginal incentive of a carbon price should give a strong reason to economise on emissions even if allocations are given free. But that pressure is intensified if weak or no adjustment implies significant losses, rather than profits simply being lower than they might otherwise be.[24]

3.23 Finally, the Department of Climate Change argued that the MCA proposal is not predicated on the assumptions made by those economists arguing that the environmental outcome is invariant to the means of allocating permits:

> It is true that, if you provide permits to people, and you do it in such a way that they are fully tradeable after you give them to them and they are not conditional on the amount of output that they continue to produce, in some circumstances you can have incentives to reduce emissions. But, as far as I am aware, that is not the proposal that the Minerals Council have been putting forward. They tie the amount of permits to the amount of production, and in that case you significantly reduce the incentives to undertake emissions reductions to achieve an environmental outcome. So, in terms of the actual proposal that the MCA has been talking about, there is a significant blunting of the environmental incentives compared with the Carbon Pollution Reduction Scheme.[25]

3.24 The question therefore before the committee is whether the amount of temporary EITEs assistance provided in the bills is appropriate, and whether circumstances exist to justify the increased level of support announced on 4 May 2009.

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23 *White Paper*, p. 9-3.

24 Sir Nicholas Stern, *A Blueprint for a Safer Planet*, 2009, p 108.

25 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Legislation Committee on Finance and Public Administration Hansard (Estimates)*, 29 May 2009, p. 24.

Is the revised level of assistance adequate?

3.25 The committee was presented with a diverse range of views about the potential impact of the expansion of temporary EITE assistance through the global recession buffer.

3.26 The increased assistance was welcomed by organisations representing the industry sector, including the Australian Industry Group (Ai Group) and the Business Council of Australia.[26] However, these groups have flagged their intention to continue working with government on the content of the package, and both have nominated EITEs assistance as an area where improvements are possible. Both organisations have stopped short of saying the level of assistance is now sufficient:

> **Senator EGGLESTON**—To go specifically to some of the changes, you talked about emission-intensive, trade-exposed industries, but under these changes there is only going to be a five per cent increase in coverage for a period of five years from 90 to 95 per cent, from 60 to 65 per cent and then five-yearly reviews. Five per cent in many quarters is not regarded as a very sufficient additional coverage. What is your opinion?
>
> **Mr Burn**—I just wonder if coverage is the appropriate term. What the five percent will do will be for those activities raise the overall allocation to 94 and a half per cent—
>
> **Senator EGGLESTON**—That is what we are talking about, yes.
>
> **Mr Burn**—The 10 per cent increase for the lower threshold will raise it to 66 per cent. Is that adequate? That is a different issue, but it is better than what was on offer before. That is why we welcomed the changes, of course.[27]

3.27 Other industry representatives recorded views more forcefully that the level of temporary assistance provided under the bills for trade exposed industries, even including the global recession buffer, remains inadequate:

> Rio Tinto retains the position that all EITE activities should maintain their initial percentage allocation of permits (ie, 60 per cent and 90 per cent as well as the additional recession buffer) until 80 per cent of all carbon emissions globally are covered by a comparable carbon constraint.[28]
>
> The Amended Draft Legislation does not remedy the fundamental flaws that have been addressed in all previous submissions. The negative impact on the international competitiveness of trade exposed Australian industry, such as the LNG industry, in an international market has the potential to cost Australian jobs and tax revenues, not have the intended effect on

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26 Mr Peter Burn, Director Policy, Australian Industry Group, *Proof Committee Hansard*, 29 May 2009, p. 13.; Ms Maria Tarrant, Director, Policy, Business Council of Australia, *Proof Committee Hansard*, 22 May 2009, p. 13.

27 *Proof Committee Hansard*, 29 May 2009, p. 16.

28 Rio Tinto, *Submission 23*, p. 7.

> reducing global emissions and in fact probably increase global GHG emissions.[29]
>
> The change to the assistance for emissions-intensive, trade exposed (EITE) industries announced on 4 May 2009 will do little to relieve the burden that will be imposed on Caltex's two oil refineries. We currently expect a nominal assistance rate of 60% although this is still subject to negotiation with the Department of Climate Change and the Government. The proposed Global Recession Buffer will reduce the CPRS productivity tax from a nominal rate of 40% to 34% for five years, which does little to cut the burden in the first five years and nothing in the longer term.[30]

3.28 Some analysts from the finance and investor sectors recorded their view that the current level of assistance is now satisfactory, and that the CPRS is now no longer a matter for concern from the point of view of investors:

> Based on research by IGCC members Goldman Sachs JBWere and Citi Investment Research on the top 100 listed companies in Australia, IGCC believes that compensation to EITE companies will result in minimal financial impact on these companies in the short to medium term. IGCC believes the extension of compensation levels means that existing investors in these companies will receive sufficient protection to avoid capital flight in the early years of the scheme.[31]
>
> Most fund managers I speak to are pretty sanguine, feeling that the impact of the CPRS will be small given the number of free permits that will be allocated. They feel that other influences like commodity prices, exchange rates and the state of the global economy are more important to their investment decisions.[32]

3.29 The Committee's attention was also drawn to studies that show that industry typically overstates the cost and difficulty of adjusting to environmental measures:

> I have a report by the Economic Policy Institute in Washington, which did an analysis of the before and after costs of pollution regulations in America, including some that are directly parallel in terms of capturing emissions from industrial plant. Without exception they found that the costs were exaggerated…[33]

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29 ConocoPhillips, *Submission 26*, p. 4.

30 Caltex Australia, *Submission 27*, p. 2.

31 Investor Group on Climate Change, *Submission 41*, p 3.

32 Ms Elaine Prior, Director and Senior Analyst, Citi Investment Research, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 84.

33 Mr Paul Toni, World Wildlife Fund, *Proof Committee Hansard*, 29 May 2009, p 66. The literature survey, 'Falling prices: cost of complying with environmental regulations almost always less than advertised' shows that in eleven of twelve the initial estimates of compliance costs were more than double the actual costs.

3.30 A number of organisations expressed their opposition to the increased level of assistance provided by the global recession buffer. For many of these organisations, this is consistent with their opposition to the previous level of EITE assistance on offer before the Government's announcement on 4 May 2009. As noted above, many groups regard the arguments about carbon leakage as exaggerated.

3.31 Uniting Justice Australia noted its concern about the additional level of assistance provided via the buffer:

> The Uniting Church has been supportive of assistance to Australia's most emissions-intensive, trade-exposed industries, on the grounds of avoiding 'carbon leakage'…We are, however, concerned about the increased assistance to EITE industries through the 'Global Recession Buffer' and the potential for increasing costs in other parts of the economy and potentially reducing the incentives and economic signals driving investment towards low-carbon industries and activities.[34]

3.32 Several environmental groups saw the revenue to be allocated to industry assistance as being better used to promote alternative sources of energy.[35] For example, the Australian Conservation Foundation advised:

> …senators may be aware of a report we commissioned from Risk Metrics recently that showed that, following the changes as of 4 May, free permits worth $16.4 billion would be handed out to our most polluting industries and coal power generators over the first five years of the scheme. That would include $565 million worth of free permits for Rio Tinto in just the first full year of the scheme.
>
> That is a very large figure. If the $16.4 billion permits were actually auctioned rather than given away that would be enough to fund at least 30 large scale solar plants, based on the government's budget announcement. That is enough to put a solar plant next to every coal-fired power station in Australia. To this end, we have been calling for the assistance to the big polluters to be limited and for 20 per cent of the CPRS revenue to be put into renewable energy and low emissions technologies to help boost our moves towards a low carbon economy.[36]

3.33 The Climate Action Network Australia advised the committee that five of its 67 member associations support passing the legislation if further amendments were considered, whilst 14 rejected the changes.[37]

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34 Uniting Justice Australia, *Submission 5*, p. 3.

35 Mr John Hepburn, Coordinator, Climate and Energy Campaign, Greenpeace Australia Pacific, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 21.

36 Mr Owen Pascoe, Australian Conservation Foundation, *Proof Committee Hansard*, 29 May 2009, p. 68.

37 Climate Action Network Australia, *Submission 2*, p.1.

3.34 Professor Ross Garnaut noted that the package could lead to some companies receiving more assistance than necessary to avoid carbon leakage:

> I am on the public record in my report and also in the evidence I gave to this committee and the other Senate committee earlier in saying that I do not think that Australia has adopted the ideal approach to assistance for trade-exposed industries. I now accept that we are not going to get a big reform of that except in the context of changes in the international environment—a comprehensive agreement that leads to comparable emissions constraints in the main countries or agreement perhaps within the WTO on comparable ways of achieving these things. Under the proposal of the government, comparing that with the assistance that industries would get under a principled approach that really dealt with the carbon leakage issue in an efficient way, my assessment, my estimate, would be that a number of industries are getting much more than would be necessary to avoid carbon leakage and some would be getting less. I have accepted that that is where our discussions are at the moment and we need progress in the international sphere to unwind the imperfections in the system.[38]

Review of assistance mechanisms

3.35 There have been calls to ensure that industry assistance does not continue longer than necessary; other stakeholders argued that industry assistance should not cease too soon if the rest of the world has still not taken appropriate action.

3.36 Professor Ross Garnaut advised that EITE assistance should continue no longer than necessary:

> I think the most important thing is that we make it clear we are going to get rid of the system of assistance for trade exposed industries when the rationale for it disappears. The rationale will have disappeared either when we have comparable emissions constraints in a large part of the rest of the world or when the major countries of the world have agreed on a comparable and principled approach to assisting trade exposed industries.[39]

3.37 This points to the need for robust review mechanisms to be in place. This is recognised by the Government in its characterisation of EITE assistance as 'transitional' and the establishment of independent review processes to consider any modifications to the EITE assistance programme.[40]

3.38 A number of changes have been made in the bills to the processes for reviews of assistance. In particular, more detail has been provided on provisions relating to matters to be considered in the five-yearly independent reviews of assistance and in

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38 Professor Ross Garnaut, *Proof Committee Hansard*, 22 May 2009, p. 15.

39 Professor Ross Garnaut, *Proof Committee Hansard*, 22 May 2009, p. 18.

40 CPRS Bill 2009 *Explanatory Memorandum*, pp 252-4.

the composition of expert advisory committees. These changes are reflected in clause 353 and subclause 360(5).

3.39 The need to wait five years for a formal review received some comment in evidence provided to the committee. In particular, the five year duration of the global recession buffer, and its extent, were criticised by some witnesses:

> We certainly do not support the five-year notice period provided to EITEs. We believe that is certainly way too long. A five-year notice period really does make it difficult for us to move with new developments in climate change science, in international developments and in new technologies that are coming forward. As I believe the previous speaker was outlining, we have seen in other pieces of environmental legislation that the costs after the fact are actually found to be a lot less than predicted. We certainly would not want to lock in assistance which turned out to be overgenerous, more than was necessary to compensate these industries.[41]

3.40 The Department of Climate Change, noted some of the factors that can be considered in the reviews of industry assistance:

> There are three levels of the nature of the change in assistance. The first is the 1.3 per cent per year reduction in the rate of assistance which happens each year, and that is an automatic reduction in the rate of assistance. The second is the removal of the global recession buffer after a five-year period. The third is that, if there is a review conducted of the international environment, the review would essentially look at the extent of carbon constraints that have been imposed in the rest of the world.
>
> An important part of that review is that it will need to look at both industries and sectors to look at carbon constraints in different areas, but it would also have to look at the total level of emissions reductions commitments across the globe. The broad intention is to look at the extent of carbon constraints in different countries, bearing in mind that they will not all be in the form of emissions trading schemes and they will not all be in the form of carbon taxes. So the review will have to do an analysis of the effective level of carbon price imposed in each country.[42]

3.41 Mr Daniel Price of Frontier Economics noted that, whatever formal timelines exist for review, it was likely that governments would monitor the scheme throughout and make adjustments as required. He cited the experience of reform of electricity markets:

> This is in the realm of highly organised energy markets, in that there are very strict rules of engagement and price-setting rules. I was always in favour, going back 15 years, of having a review soon after that market

41 Mr Owen Pascoe, Australian Conservation Foundation, *Proof Committee Hansard*, 29 May 2009, p. 73.

42 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 10.

> started in case we got something fundamentally wrong. In fact, the Western Australian Labor government put in place an electricity market there which was very different from any other market in Australia and they required an annual review. In the first review, the regulator there took the view that there were signs the market may not be working quite as they intended but that the market should be allowed to continue on, and so they kept a watching brief over that. But let us say that there was a timed review in 2014. Governments do not just walk away and let a market fall apart. Almost certainly, any responsible government, if they saw something going fundamentally wrong, would probably step in and make a change. So I think it is probably a moot point as to whether it is a timed review or one that is ongoing, because governments generally are pretty responsible about these things.[43]

Comparison with US Waxman-Markey Bill

3.42 One of the arguments against the currently proposed level of industry assistance provided to the committee was the assertion that other countries were providing a higher level of support to their own trade exposed industries. A frequently used example was the American Clean Energy and Security Act 2009 (commonly known as the Waxman-Markey Bill), which was passed by the United States House of Representatives Committee on Energy and Commerce on 21 May 2009.

3.43 An example of some of the views expressed in relation to the US Bill was the following call for greater alignment with US proposals made by Bluescope Steel/OneSteel:

> Given the global significance of the US, we believe that it is important to obtain a clear understanding of the design of United States' emissions trading scheme, including its provisions for assistance to EITEs, and to fully consider the implications of the US approach for the design of Australia's CPRS. The current draft US legislation appears to differ markedly from the Australian scheme in a number of important respects, including the later commencement date, broader activity coverage for affected sectors including steel, and a more prescriptive and quantitative test for international action.
>
> The precedent set by the US is particularly important for the iron and steel industry. Approximately 30% of BlueScope Steel's exports from its Australian operations go to the United States. The Australian steel industry also competes with US steel producers in third party export markets. It is essential that material differences between Australian and US climate change legislation do not distort our trade competitiveness.
>
> At a minimum, the Government should ensure that the important precedent set by the US is acknowledged, and that it has sufficient flexibility to adjust the CPRS as US policy becomes clearer. This will assist in ensuring that

43 *Proof Committee Hansard*, 22 May 2009, pp 40-41.

> Australian industry is not put at a disadvantage with respect to its international trade competitors.[44]

3.44 The Department of Climate Change has responded to unfavourable comparisons between the proposed levels of industry assistance in the CPRS Bills and in the US proposal in the following terms:

> Most importantly however, and contrary to some of the reporting, neither scheme guarantees 100 per cent assistance to industries at risk of carbon leakage.
>
> In fact, the Waxman-Markey Bill has set a hard cap on allocations to these industries at 15 per cent of total permits in 2014, falling to 13.4 per cent in 2016. This initial allocation is substantially lower than the CPRS policy, where around 27 per cent of permits will be allocated to EITEs in the first year of scheme. Direct comparisons of these shares should be treated with caution given the different economic structures of the two countries, but information provided to the Committee via testimony from a US energy intensive industry representative suggests that even at commencement, assistance to EITE industries could be less than 100 per cent.
>
> The number of permits that will be allocated to these industries over subsequent years will be directly linked to the decline in the US cap on emissions, with no provision for increased allocations in response to growth in these industries – in this sense there are similarities with our Green Paper model but with a lower share of permits available for EITEs.
>
> This means that if the calculated allocations to US EITEs are greater than the number of permits that have been set aside for them, allocations to each EITE will be reduced accordingly. In addition, if emissions from US EITEs increase (on account of these sectors growing) and the overall cap on emissions falls, the effective rates of assistance to EITE industries will decline. This is because the number of permits available for allocation to EITEs will be falling while the total number of emissions from these industries is increasing.[45]

3.45 The Department of Climate Change has provided the attached chart to summarise the different levels of assistance to trade exposed industries under the CPRS Bills and the latest version of the Waxman-Markey Bill. As discussed by Mr Comley in the preceding paragraph, the proposed rate of assistance for trade exposed industries under the Waxman-Markey Bill will decline as a proportion of emissions liability over time:

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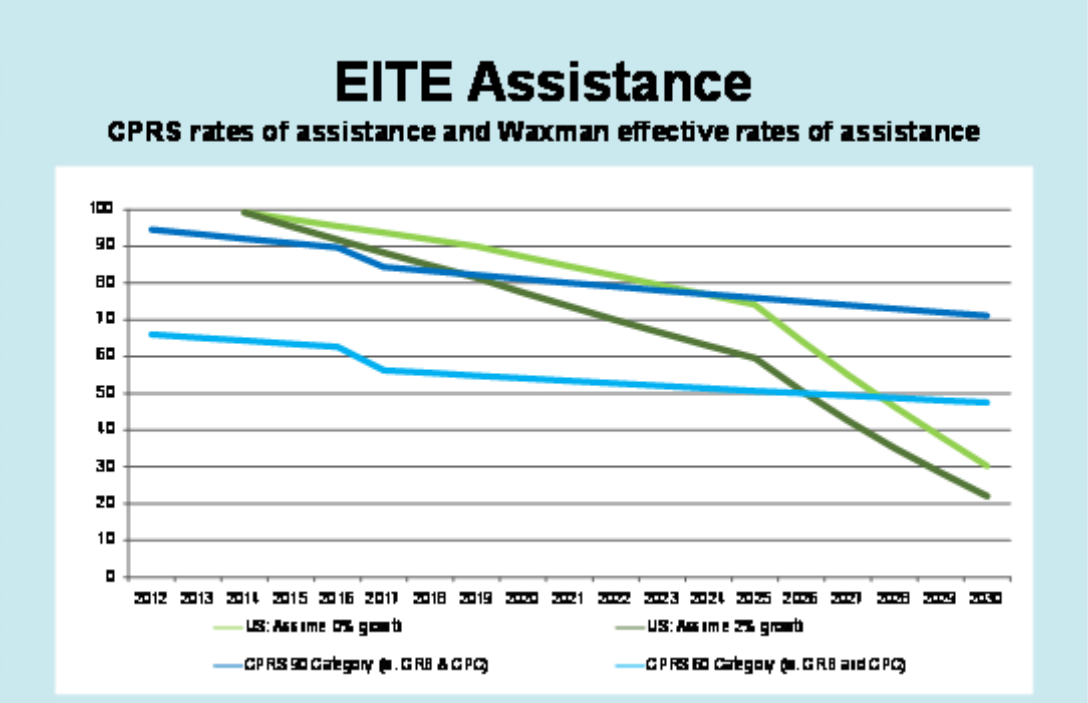
44 Bluescope Steel/OneSteel, *Submission 10*, p. 2.

45 Mr Blair Comley, Deputy Secretary, Department of Climate Change, Speech to APPEA conference and exhibition, http://www.climatechange.gov.au/media/2009/pubs/Comley_APPEA.pdf, viewed 3 June 2009, pp 9-10.



Source: Mr Blair Comley, Deputy Secretary, Department of Climate Change, Speech to APPEA conference and exhibition, http://www.climatechange.gov.au/media/2009/pubs/Comley_APPEA.pdf, viewed 3 June 2009

3.46 There may be many iterations of the Waxman-Markey bill, including the level of assistance provided to export industries, before it is ultimately passed by the US Congress. However, it is likely that any bill passed by Congress will include some level of assistance for trade exposed industries.

Detail in regulations

3.47 A number of stakeholders expressed concern that important details of the EITE assistance programme will be contained in the regulations:

> We also remain concerned that EITE activities will be defined in regulations rather than legislation, despite the fact that these definitions will be crucial in determining whether the Government delivers on its commitment to ensure no competitive disadvantage for EITEs. Similarly, the eligibility criteria for EITE assistance and the timing and rate of decay in EITE assistance – both critical issues for the iron and steel industry - are also not dealt with in the Bill but will be dealt with in regulations.[46]

3.48 Others express concern that the proposed regulations are not currently available:

> I think there is for us a concern around the sequencing of the act versus the regs. A lot of the detail to do with the emissions-intensive trade-exposed is

46 Bluescope Steel/OneSteel, *Submission 10*, p. 2.

> in the regs, and that is what we will want to see. I still can imagine that you can get both the regs and the act reviewed by business before the end of the year.[47]

3.49 The Explanatory Memorandum provides the following explanation for the detail of the EITE assistance programme being provided in regulations:

> The technical aspects of precisely defining emissions-intensive trade-exposed activities, the eligibility criteria and relevant production units, and the need for flexibility to include new activities, make the program appropriate to locate within regulations rather than the bill itself. After the detail on emissions, electricity use, revenue and/or valued added has been assessed for a given activity, the regulations will be able to provide a relatively simple allocation methodology per unit of production which provides investment certainty, minimises ongoing compliance costs and reduces the risk of assistance decisions being subject to lengthy appeal and review process which may divert resources from more important issues for business.[48]

3.50 The Department of Climate Change has indicated that at least some of the regulations will be available as exposure drafts before the Parliament votes on the CPRS Bills (currently anticipated before the end of June 2009):

> I think the emissions-intensive trade-exposed area is the clearest example of what is happening. The intention is to release some exposure draft regulations before there is a vote—before the Senate considers the bill finally. It is unlikely to be possible to have all the emissions-intensive trade-exposed activities listed at that time, and that is essentially because there is that process going on with the affected industries about defining precisely what the activities are and then collecting audited data to feed into what the actual rates of assistance are…I think the tranches of regulations that will come through and be available at the time, plus the policy commitments that were made in the white paper, will give an indication of where that process will end up.[49]

Committee view

3.51 As previously noted, the Committee regards the provision of assistance to emissions-intensive trade exposed industries as appropriate to guard against the risk of carbon leakage.

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47 Ms Maria Tarrant, Business Council of Australia, *Proof Committee Hansard*, 22 May 2009, p. 25.

48 Carbon Pollution Reduction Scheme Bill 2009 *Explanatory Memorandum*, p. 119.

49 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 13.

3.52 In view of the extraordinary circumstances presented by the global financial crisis, the Committee regards the expansion of assistance via the global recession buffer as prudent.

3.53 The Committee notes the assurance of the Government that at least some elements of the regulations will be available for consideration before the Senate considers the legislation, and that regulations will likely reflect the commitments of the *White Paper*.

3.54 The Committee, while recognising that it is not unusual for regulations to be formulated after a Bill is presented to Parliament, encourages the Government to make as much of the draft regulations available as soon as practicable.

Changes to rules on landfill

3.55 Methane emissions arise from the decomposition of organic matter in landfill. These emissions can occur a long time after the waste was deposited in landfill – as noted by the Department of Climate Change, 'estimates [of emissions from landfill] in any year include a large component of emissions resulting from waste disposal over the preceding 50 years. This means recent changes in waste management only impact reported methane levels over time'.[50]

3.56 In 2006, methane emissions from solid waste disposal on land were 13.2 MT CO_2e, or 2.3 per cent of net national emissions. Once waste has been disposed of to landfill, one of the few means of reducing emissions is to put in place methane gas capture (for energy generation purposes) or by flaring the emissions. In 2006, 4.6MT CO_2e of methane was recovered from solid waste.

3.57 The Government's original proposal for dealing with emissions from waste deposited prior to the commencement of the scheme ('legacy waste') was to include certain special arrangements for landfill facilities. These were included in the *White Paper* and in the exposure draft of the CPRS bill. These included:

- Establishing a separate emissions liability threshold of 10,000 tonnes of CO_2e for landfill facilities within a prescribed distance of other facilities (this was established to prevent 'waste displacement from covered to uncovered sites'), particularly in urban areas.[51] All other landfill facilities would use the scheme's standard 25,000 tonne threshold;
- Excluding all facilities which closed before 1 July 2008; and
- Excluding emissions from facilities attributable to 'legacy waste' for the period to 1 July 2018.

50 Department of Climate Change, *National Greenhouse Gas Inventory 2006*, 2008, p. 14.

51 *White Paper*, p. 6-37.

3.58 The Government estimated in the *White Paper* that legacy emissions would fall between 30 and 60 per cent between the release of the *White Paper* and 1 July 2018. 'Excluding legacy emissions for this period will reduce the financial impact on landfill operators accordingly and will allow time to assess other abatement opportunities'.[52]

3.59 The waste sector raised concerns at this treatment. The Australian Landfill Owners Association (ALOA) informed the Committee during its inquiry into the exposure draft of the CPRS bills:

> The inclusion of legacy waste in the CPRS (as of 2018) is the equivalent of retrospectively taxing landfill owners and their customers for waste deposited as early as 1968…Penalising landfill owners from 2018 onwards does not in any way have an impact on waste generation or waste composition modification as this waste has already been deposited…the cost of legacy waste emissions simply cannot be passed on to our current customers as a CPRS charge as the liability was created by past customers. Therefore, it will be pushed into the market as a base price increase.[53]

3.60 ALOA also raised ongoing concerns about methodologies used to calculate emissions from landfill.

3.61 In the bills as introduced into the Parliament, the Government has refined the treatment of emissions from landfill. The principal changes are:

- To exclude emissions from waste deposited before 1 July 2011 from being counted towards the operator's emission liability (i.e. the operator of the facility will not need to surrender emissions units for these emissions). However, legacy emissions will still be counted toward whether a facility meets the 25,000 tonne or 10,000 tonne liability threshold. The detail on how the facility's annual legacy emissions profile will be determined will be provided in regulations;[54] and
- To clarify that the 10,000 tonne threshold will apply to facilities within a prescribed distance of other facilities which exceed the 25,000 tonne threshold and which accept a similar classification of waste.[55] The distance will be prescribed in regulations.

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52 *White Paper*, p. 6-33

53 Australian Landfill Owners Association, *Submission to Senate Economics Committee inquiry into the exposure draft of the legislation to implement the Carbon Pollution Reduction Scheme (Submission 50)*, pp 2-3.

54 CPRS Bill 2009, *Explanatory Memorandum*, p. 39.

55 Department of Climate Change, 'Summary: Key Changes to the Carbon Pollution Reduction Scheme Legislation,' May 2009, p. 3, http://www.climatechange.gov.au/emissionstrading/legislation/pubs/summary_changes_to_exposure_draft_bills.pdf, viewed 27 May 2009.

3.62 The Government has indicated that the changes on legacy emissions was a direct response to feedback from affected stakeholders, and in particular the views of local government concerning potential impacts on ratepayers.[56]

3.63 The changes to treatment of landfill have been broadly supported by industry. The Australian Industry Group describing the changes as a 'victory for common sense,' whilst noting some ongoing uncertainties with regard to measurement methodologies.[57] The changes announced by the Government have also been welcomed by the Australian Local Government Association.[58]

3.64 The ALOA has also welcomed the removal of legacy waste emissions from the CPRS.[59] However, ALOA did note continuing concerns with regard to methodologies used under the National Greenhouse and Energy Reporting System with regard to calculation of waste emissions, but expressed satisfaction that the Department of Climate Change was responsive to these issues.[60]

3.65 A more significant concern was the impact of the removal of incentives for methane gas capture and energy production following the cessation of the NSW Greenhouse Gas Abatement Scheme (NGAS):

> The situation today is the landfill gas operator has three sources of income. He has income coming from the landfill operator; he has income coming from the sale of the electricity itself at normal tariff rates; and he has RECs, the renewable energy certificates. That is what he has going forward… About 40 per cent of these companies' revenue comes through NGAS or through Greenhouse Friendly, so they get paid for the power; they are paid generally something from the landfill operator and they get paid for renewable energy certificates. But they will lose NGAS under the current scheme…The people who actually created this 12 per cent reduction over the last 10 years are the two companies, Energy Development Limited and LMS, and both of those that actually created all the good work are going to be penalised. Both the companies are in jeopardy because of the loss of this revenue.[61]

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56 Hon Greg Combet MP, Parliamentary Secretary for Climate Change, Media Release GC 03/09, 'Coverage of landfill under the CPRS', 14 May 2009

57 Ms Heather Ridout, Chief Executive, Australian Industry Group, Media Release, 'CPRS landfill waste changes a victory for common cause,' 14 May 2009.

58 Australian Local Government Association, Media Release, 'ALGA applauds removal of legacy waste from CPRS,' http://www.alga.asn.au/newsroom/media/2009/20090514.php, viewed 28 May 2009.

59 Mr Max Spedding, Secretary, Australian Landfill Owners Association, *Proof Committee Hansard*, 29 May 2009, p. 2.

60 Mr Max Spedding, Secretary, Australian Landfill Owners Association, *Proof Committee Hansard*, 29 May 2009, p. 16.

61 Mr Max Spedding, Secretary, Australian Landfill Owners Association, *Proof Committee Hansard*, 29 May 2009, pp 5-6.

3.66 Mr Spedding called for transitional arrangements to be put in place to cover the loss of revenue arising from the cancellation of the NGAS and similar schemes.

3.67 The committee notes that the Government has undertaken to work with the NSW and ACT Governments on arrangements for termination of the NGAS.[62] The Committee would encourage these discussions to be concluded swiftly, in consultation with affected stakeholders, to ensure that meaningful projects in methane gas capture and storage are not jeopardised.

3.68 The Committee commends the government for responding to the concerns raised by industry in regard to legacy waste emissions.

The Energy Efficiency Trust

3.69 As part of a suite of changes to the Exposure Draft legislation announced on 4 May 2009, the Government proposed to establish a $50.8 million Energy Efficiency Trust. Along with the Energy Efficiency Savings Pledge Fund, it forms the Australian Carbon Trust, whose stated purpose is 'to help all Australians to do their bit to reduce Australia's carbon pollution and to drive energy efficiency in commercial buildings'.

3.70 The Energy Efficiency Trust will provide funding to cover upfront capital costs for businesses seeking to undertake energy efficiency measures. Businesses would pass the cost savings back to the Trust at a commercial rate until the borrowed costs (with interest) are repaid.[63]

Other changes to the legislation affecting business

3.71 The committee notes that the Government has made a number of other changes to the bills in response to feedback from stakeholders on the exposure draft bills.[64] These include clarifications of the application of the CPRS to the Joint Petroleum Development Area and Greater Sunrise Field (between Australia and Timor-Leste), technical changes to the operation of Obligation Transfer Numbers (OTNs), amendments to provisions relating to Liability Transfer Certificates and Enforcement Provisions. Although few witnesses at hearings made reference to these changes, some submissions referred to these issues.

3.72 Technical suggestions were made in relation to OTNs and Liability Transfer Certificates by BP Australia,[65] the Energy Supply Association of Australia,[66]

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62 *White Paper*, p. 15-9.

63 Once the initial capital cost has been repaid, the business keeps the ongoing cost savings from its investment.

64 Department of Climate Change, 'Summary: Key changes to the Carbon Pollution Reduction Scheme legislation,' May 2009, p. 1, http://www.climatechange.gov.au/emissionstrading/legislation/pubs/summary_changes_to_exposure_draft_bills.pdf, viewed 27 May 2009.

65 BP Australia, *Submission 19*, pp 3-4.

Woodside Petroleum[67] and Caltex Australia.[68] Rio Tinto and Woodside raised a number of concerns in relation to the operation of Liability Transfer Certificates as a means of resolving liability between a controlling corporation and other entity within the corporate structure.[69]

3.73 ConocoPhilips expressed concern concerns that the implications of the CPRS on Timor Leste need to be more fully understood. APPEA also expressed concern about this issue.[70]

3.74 Leighton Holdings repeated its concern about the use of 'operational control' to determine liability for reporting emissions under the *National Greenhouse and Energy Reporting Act 2007* (NGER Act) and under the CPRS. It argued in its submission that the Liability Transfer Certificate mechanism, even as amended, does not resolve these concerns, primarily due to the timing of commencement of the CPRS bills after the first year of reporting under the NGER Act:

> The mechanism to address the contract mining issue in the CPRS Bills, the Liability Transfer Certificate (LTC), is a second-best solution because parties need to resolve the 'operational control' issue under NGERS before registering under the Act by 31 August 2009 and not under the CPRS in 2011.
>
> If mining contractors, such as Leighton Holdings' subsidiary companies, have operational control of a facility under NGERS they will therefore be the liable entity under the CPRS. Leighton Holdings will be in the invidious position of having to spend millions of dollars to set up systems, review and renegotiate contracts and collect data to meet NGERS obligations for three reporting years until there is a possibility of transferring these responsibilities using the LTC mechanism. There appears to be little gain to the Government and a significant burden to our business with this approach.[71]

3.75 The Committee agrees that it is desirable that the entity which is ultimately likely to have CPRS liability should be the entity which has responsibility for providing reports on emissions under the NGER Act prior to commencement of the CPRS. The Committee encourages the government to liaise further with the industry in relation to this problem.

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66 Energy Supply Association of Australia, *Submission 30*, pp 11-12.

67 Woodside Petroleum, *Submission 28*, p. 4.

68 Caltex Australia, *Submission 27*, p. 7.

69 Rio Tinto, *Submission 23*, pp 2-3; Woodside Petroleum, *Submission 28*, p. 5.

70 ConocoPhilips, *Submission 26*, p. 3; Australian Petroleum Production & Exploration Association, *Submission 33*, p. 13.

71 Leighton Holdings, *Submission 18*, pp 3-4.

Chapter 4
Voluntary action

Background

4.1 In April this year, the Senate Economics Committee noted in its report on the CPRS Exposure Draft that many submitters had expressed concern that 'voluntary' action by households would not lead to a reduction in Australia's greenhouse gas emissions.[1] The argument is as follows. Many households (as well as businesses, local and state governments) take action to reduce their emissions, which is primarily motivated by altruistic concern for the environment.[2] However, under the proposed CPRS, these additional reductions will simply free up more permits for liable entities to purchase and to increase their emissions. This criticism of the CPRS, therefore, is one of design—it would set not only a ceiling on emissions, but also a floor.[3]

4.2 A leading consumer advocacy organisation welcomed the Committee's comments:

> CHOICE is encouraged by the Committee's recognition of the importance of voluntary action and the recommendation for the government to develop policies in this area. We look forward to working with the government to identify practical means to recognise and account for consumer's voluntary action.[4]

4.3 In February 2009, the Minister for Climate Change, Senator the Hon. Penny Wong, rightly noted that voluntary action to invest in energy efficient practices will not only save households money, but will also help make it easier for governments to set even more ambitious targets in the future.[5] The Exposure Draft stated that in making a recommendation to set the national scheme cap, the Minister *may* have regard to 'voluntary action which is expected to be taken to reduce Australia's greenhouse gas emissions'.[6] The Commentary to the draft noted that 'voluntary action to reduce greenhouse gas emissions can help ameliorate the economic implications

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1 *CPRS ED Report*, Chapter 8.

2 In other words, it is not principally motivated by financial cost.

3 See Dr Richard Denniss, 'Fixing the floor in the ETS: The role of energy efficiency in reducing Australia's emissions', *Research Paper No. 59*, The Australia Institute, November 2008. Several submissions to the Senate Economics Committee's inquiry into the Exposure Draft also identified this issue as a problem. See submissions 3, 5, 21, 33, 35, 42, 49, 52, 55, 74, 79, 82, 84, 87, 93, 97, 107, 110, 111, 112, 116 and 122 of the *CPRS ED Report*.

4 Choice, *Submission 31*, p 3.

5 The Hon. Penny Wong, 'ETS is better than a tax', *The Australian*, 23 February 2009, p. 8.

6 Carbon Pollution Reduction Scheme Bill, *Exposure Draft*, Clause 14(5)(c)(iv).

associated with various levels of national scheme caps, making it more likely that more stringent caps can be set over time'.[7]

4.4 On 4 May 2009, the Government announced that it would make changes to the Exposure Draft of the CPRS bill to enable households to have direct influence on the carbon permit market. First, the government committed to establish an Energy Efficiency Savings Pledge Fund to allow households to retire carbon permits. Second, GreenPower purchases above 2009 levels will be directly recognised when the Government sets CPRS caps. This chapter examines these initiatives and the mechanism in the CPRS bill for the Minister to take voluntary action into account when setting scheme caps and gateways.

4.5 Finally on 7 June the Government announced it would hold public consultation workshops across the country to look further at how voluntary action can best be taken into account when setting future caps. Voluntary actions to be taken into account may include increases in the uptake of energy efficient appliances, the construction or renovation of houses to a star-rating above the minimum required and the use of public transport.[8]

Accounting for voluntary action in setting the cap

4.6 A key concern of the Senate Economics Committee in its inquiry into the Exposure Draft of the CPRS bill was that clauses 14 and 15 would not ensure that voluntary action is recognised transparently and systematically. Accordingly, the committee recommended in its report that subsection 14(5) be reworded such that the Minister 'shall have regard' (rather than 'may have regard') to voluntary action.[9]

4.7 The Department of Climate Change told this committee that the Government had taken legal advice on this recommendation and decided to address this issue:

> …through a statement in parliament and in a commitment to address voluntary action in that statement. The approach that has been adopted addresses the committee's concerns by ensuring that voluntary action will be taken into account in a transparent way.[10]

4.8 The CPRS bill now requires a written statement to be tabled in parliament outlining the Minister's reasons for regulations underlying scheme caps and gateways.[11]

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7 Carbon Pollution Reduction Scheme Bill, *Exposure Draft*, Commentary, p. 88.

8 Media Release, Hon Penny Wong, 7 June 2009, http://www.environment.gov.au/minister/wong/2009/pubs/mr20090607.pdf

9 *CPRS ED Report*, pp. 73–74.

10 Mr Barry Sterland, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 2.

11 *Carbon Pollution Reduction Scheme Bill 2009*, sections 14 and 15.

Buying and retiring permits

4.9 A related concern of the Senate Economics Committee was that the voluntary action problem could not be adequately solved by households buying and surrendering permits on the open market. The Government has emphasised the ability of any person to purchase and cancel Australian emissions units, and for the Government to subsequently cancel a Kyoto unit. The Department of Climate Change explained that the original CPRS (as set out in the Exposure Draft) allowed 'anyone to purchase permits and essentially submit them to the regulator to have them torn up'.[12]

4.10 The Senate Economics Committee report commented that the ability of concerned citizens to buy and cancel permits is not in itself a sufficient outlet for voluntary action. The committee cited—and agreed with—the comments of Professor Alan Pears of RMIT that buying and surrendering permits is 'not very emotionally satisfying'.[13] Professor Pears argued that taking permits out of the system leaves the additional abatement action to the liable entities, not those who surrender the permits. This effectively takes from them the ability to reduce emissions in a manner that also achieves other goals. As Dr Richard Denniss, Director of the Australia Institute observed, under the proposed CPRS a household that spends $3000 to replace its off-peak electric hot water heater with a solar hot water system would have no impact on greenhouse gas emissions. However, it would make a significant impact on the level of emissions if instead they purchased permits and ripped them up.[14]

How else can households' voluntary actions count?

4.11 One way to ensure that voluntary action counts in addition to the national target is to establish a secondary market to audit and verify households' emission

12 Dr Martin Parkinson, *Proof Economics Committee Hansard*, 18 March 2009, p. 21. *CPRS ED Report*, p. 70. See also Department of Climate Change, Answers to Questions on Notice.

13 Adjunct Professor Alan Pears, *Submission to the Green Paper*, 2008, p. 4. *CPRS ED Report*, pp 71 and 73.

14 Dr Richard Denniss, 'Fixing the floor in the ETS: The role of energy efficiency in reducing Australia's emissions', *Research Paper No. 59*, The Australia Institute, November 2008, p. 9.

reductions. The permits accrued in this secondary market would be removed from the CPRS market.[15]

4.12 The Centre for Energy and Environmental Markets at the University of New South Wales has proposed that voluntary action could be recognised through an Additional Action Reserve (AAR). The AAR would annually set aside a proportion of emission units which would be retired if governments, businesses or individuals take emission reduction measures which go beyond a baseline target that emitters are expected to achieve. Through setting aside a fixed proportion of units annually, the Action Reserve would limit recognition of voluntary action and limit potential losses of auctioning revenue. If the allocated emission units are not retired in a given year, they would be returned to the market. The Centre argues that a scheme along these lines would provide a mechanism for 'defined and limited' strengthening of the national emission target which would drive domestic emission reductions rather than potentially draw on international carbon credit markets.[16]

4.13 The Committee believes that while there is merit to the idea of a systematic mechanism (such as an offsetting secondary market) to calculate and allow for voluntary action, the precise detail of this type of scheme may be contentious. The AAR would need to determine how to calculate the baseline target that emitters are expected to achieve and the proportion of permits that are to be set aside annually. These may be difficult—and administratively costly—issues to resolve.

4.14 However, in preferring the less structured approach proposed in the CPRS bill, the Committee strongly urges the Government to clarify how clauses 14 and 15 of the bill will operate. The Committee is encouraged that the Government has stated its intention to do so (see paragraph 4.6).

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15 Dr Denniss has suggested such a system with a fixed exchange rate of less than one for one between CPRS emissions permits and the proposed secondary permits for household reduction. He has argued that if two tonnes of household emissions are exchanged for one tonne of CPRS permits, the action of individual households would have a demonstrable effect on the overall level of greenhouse gas emissions nations. Dr Denniss emphasises that the key in establishing a secondary market is to 'ensure the accuracy of the measurement of both the baseline and the discretionary reductions in energy use that can be attributed to the actions of a household'. He suggests using historic data from household electricity bills but concedes that the accuracy of estimates of emissions reductions 'is unlikely ever to match the accuracy of the measurement of emissions from the burning of fossil fuels'. 'Fixing the floor in the ETS: The role of energy efficiency in reducing Australia's emissions', *Research Paper No. 59*, The Australia Institute, November 2008, p. 10.

16 Centre for Energy and Environmental Markets, 'The possible role of an Additional Action Reserve (AAR) in the CPRS to facilitate additional voluntary and policy efforts to reduce emissions', *Concept Note*, p. 1. See also Dr Regina Betz, *Proof Senate Economics Committee Hansard*, 27 March 2009, p. 118.

Energy Efficiency Savings Pledge Fund

4.15 As part of a suite of changes to the Exposure Draft legislation announced on 4 May 2009, the Government proposed to establish a $25.8 million Energy Efficiency Savings Pledge Fund.[17]

4.16 The Pledge Fund will enable households to calculate their energy use, to pledge to reduce their emissions through investing in energy efficient appliances and to buy carbon pollution permits. The Government will establish a website for this purpose and the pledges will be pooled with all contributions tax deductible.

4.17 The Fund will enable households to verify their greenhouse gas emissions, invest to reduce these emissions and to use the money saved from their lower energy use to retire permits from the CPRS market. Although the money paid by households to retire permits is tax deductible whether it is paid to the government or to not-for-profit environmental groups, the Pledge Fund's official sanction may encourage more people to engage in this process. Moreover, as the following section notes, the Government has established a mechanism to recognise directly the emission–reducing investments made by households when setting the cap.

Supporting voluntary action through GreenPower

4.18 GreenPower is a government accredited renewable energy programme whereby energy providers supply energy to households from sources such as hydro, wind power and biomass at an additional cost to the standard electricity account. This cost is then invested in the renewable energy sector. The Government's GreenPower website states that for the period 1 October to 31 December 2008, 'over 877 000 Australian homes and 34 000 businesses are voluntarily purchasing GreenPower', which represents roughly 10 per cent of Australian homes.[18]

4.19 The Government has identified GreenPower as the key 'voluntary' action undertaken by households. In its 4 May announcement, the Government stated that:

> Additional GreenPower purchases above 2009 levels will be directly recognised when the Government sets caps under the Carbon Pollution Reduction Scheme. Additional GreenPower purchases will be measured annually and future caps will be tightened on a rolling basis.[19]

4.20 The Explanatory Memorandum to the CPRS bill elaborates:

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17 As noted in Chapter 3, the Pledge Fund forms part, along with the Energy Efficiency Trust, of the Australian Carbon Trust.

18 'GreenPower now in 10 per cent of Australian homes', *GreenPower News*, 28 February 2009, http://www.greenpower.gov.au/admin/file/content13/c6/GreenPower28.pdf (accessed 22 May 2009).

19 The Hon. Kevin Rudd, 'Helping all Australians do their bit on climate change', *Media Release*, 4 May 2009.

> The Government has indicated that additional GreenPower purchases will be measured annually and taken directly into account in setting scheme caps five years into the future, on a rolling basis. For example, the 2016-17 cap will be tightened to reflect the difference between 2009 and 2011 GreenPower sales, multiplied by a factor to reflect the emissions saved. This will achieve emissions reductions beyond Australia's national targets as it will be backed by the cancellation of Kyoto units.[20]

4.21 The Committee welcomes this announcement. It notes that several submitters to the Senate Economics Committee's inquiry into the Exposure Draft of the CPRS legislation suggested that the Government could take GreenPower purchases into account when setting the national cap.[21]

4.22 A leading consumer advocacy organisation praised the measure, although wanted it taken further:

> CHOICE welcomes the Federal Government's acknowledgement that voluntary actions by consumers should be additional to the mandatory actions of the CPRS. The government's decision to recognise voluntary actions by counting new GreenPower purchases as additional when setting CPRS caps, backed by the cancellation of Kyoto units, is a small first step to implement this recognition.[22]

Recognising other voluntary actions

4.23 The Senate Economics Committee noted in its April 2009 report that in addition to GreenPower, 'there is publicly available data such as reduced energy consumption by households' that could be used to take account of voluntary action.[23] This committee is pleased that the Explanatory Memorandum (EM) to the CPRS bill details those voluntary actions—other than GreenPower—that may be taken into account by the Minister when setting scheme caps and gateways. The EM states:

> A range of other indicators of voluntary action may also be taken into account. As a matter of policy, the Government will monitor annual emissions from the household sector, and will monitor and consider the uptake of certain energy efficiency activities among households and businesses where there are clearly defined business-as-usual benchmarks, and where improvements can be detected. In doing so, the Government will consider trends in the construction or renovation of houses to a star-rating above the minimum required, the use of public transport and the expansion of public transport services, and the uptake of more energy efficient appliances (particularly those that consume a significant proportion of

20 *Explanatory Memorandum*, p. 80.

21 For example, the submissions to that inquiry from the Total Environment Centre and Greenfleet.

22 Choice, *Submission 31*, p 4.

23 *CPRS ED Report*, p. 73.

> household energy such as water heaters and airconditioners) beyond regulated levels. Action in these sectors could be taken into account by assessing the extent to which the uptake exceeds historical trends, factoring in electricity price changes, regulation and any direct government assistance.
>
> For example, the Government would collect data on the proportion of houses with a 6 star rating that are being constructed, compare this with historical trends and calculate the reduced emissions likely over the full life-cycle of the buildings. This calculation could inform the Government's cap setting decision. Another example could be monitoring the overall fuel efficiency of the passenger vehicle fleet in Australia. The trend improvements in fuel efficiency could then be compared to historical trend improvements, taking account of fuel price changes and other relevant factors. Estimates of emissions reductions could then be used to inform the Government's decision regarding appropriate scheme caps and gateways.[24]

4.24 The Explanatory Memorandum recognises that it is not possible to list all household and individual actions that could be measured and taken into account by the Minister. It rightly notes that these 'will evolve over time in response to changing carbon prices, technological developments and other economic and social developments'.[25] The committee welcomes the Government's decision to hold public workshops to further determine how voluntary action can best be taken into account when setting caps and urges the Government to continue to promote and monitor voluntary action by households and individuals, with a view to taking these emission reductions into account when setting future caps and gateways.

Conclusion

4.25 The Committee emphasises that the task of reducing Australia's CO_2 emissions extends beyond the CPRS market for liable entities. It is important that the voluntary actions of households to reduce their emissions are taken into account not only when the Minister sets scheme caps and gateways, but also in the trade of permits. In this context, the Committee welcomes the Government's initiatives to enable households to retire carbon permits and to recognise directly GreenPower purchases above 2009 levels. All these initiatives send the right message to households that they can play a valued role in reducing greenhouse gas emissions.

24 *Explanatory Memorandum*, pp 80–81.

25 *Explanatory Memorandum*, p. 81.

Chapter 5
Deferral of operation

5.1 On 4 May 2009, the Government announced 'a delay in the start date of the Carbon Pollution Reduction Scheme of one year to manage the impacts of the global recession.'[1] The delay will also be accompanied by a fixed permit price of $10 for the first compliance year of the scheme (July 2011–June 2012). This change to the timing and structure of the scheme is designed to provide greater business and investment certainty.

5.2 Table 5.1 shows the revised timetable for the introduction of the CPRS.

Table 5.1: Revised timetable for introduction of CPRS

Mar- June 2009	Consultation on exposure draft legislation; Senate committee inquiries
May 2009	Bills introduced into parliament
June 2009	Desired passage of bills
Sept qtr 2009	Regulator established
Dec qtr 2009	Legislative instruments tabled in parliament Copenhagen UN Climate Change Conference
First half 2010	Scheme caps to 2014–15 and gateways for 10 following years set
July 2011	Start of first compliance year (with fixed price permits)
First half 2012	First auction of permits
June 2012	End of first compliance year (with fixed price permits)
July 2012	Start of second compliance year
Oct 2012	Deadline for lodging of emissions reports for first year
Dec 2012	Deadline for surrender of permits for first year

Source: from *White Paper*, table 16.2; Minister for Climate Change, *Press Release*, 47/09, 27 February 2009; Prime Minister, Treasurer and Minister for Climate Change and Water, 'New measures for the carbon pollution reduction scheme', Media release, 4 May 2009.

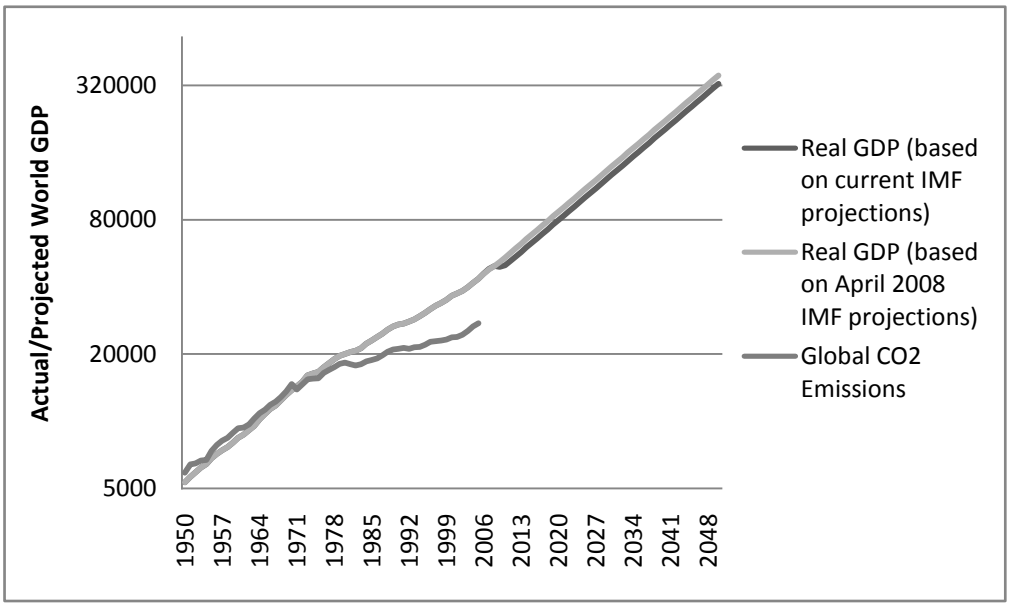
1 Prime Minister, Treasurer and Minister for Climate Change and Water, 'New measures for the carbon pollution reduction scheme', Media Release, 4 May 2009.

The global financial crisis and the delayed start

5.3 The economic outlook has deteriorated sharply over the past year. The size of the deterioration is illustrated by Chart 5.1. This shows the growth of global real GDP since 1950 (the upper line) and two forecasts—one based on the current International Monetary Fund projections and one based on those made a year ago.[2] The chart is on a logarithmic scale, so the slope of the lines represents growth rates.

5.4 The lower line in the chart shows the path of global CO_2 emissions. It is notable that the price signals arising from the mid-1970s oil crisis led to a marked slowing in emissions relative to economic activity.

Chart 5.1: Global real GDP and CO_2 emissions



Sources: Chart generated by Secretariat based data from IMF, *World Economic Outlook*; A Maddison, *The World Economy: Historical Statistics*, OECD, 2003; World Resources Institute, CAIT database.

5.5 The Department of Climate Change explained that the global financial crisis drove the delayed start date, (as well as the use of a fixed price for the first year of the scheme and the augmentation of the emissions-intensive trade-exposed assistance).[3]

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2 The IMF's April 2008 *World Economic Outlook* has projections to 2013 and the April 2009 issue out to 2014. In both cases the forecasts have settled down to around 4.8 per cent growth in the final projection years and this growth rate is assumed to continue to 2020 in the chart. The CO_2 emissions exclude those due to land use change and forestry. The units used in the chart are billions of 1990 (international Geary-Khamis) dollars for GDP and millions of tonnes for CO_2 emissions.

3 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 7.

5.6 Professor Garnaut does not believe that the global financial crisis is a good economic reason for delaying the start date but concedes it makes prompt action more politically difficult:

> It does affect the political difficulty of achieving an Australian and international policy outcome that reflects Australia's national interests. The depth of recession is a good time to invest in the new processes and industries that will make Australia's low emissions economy of the future [but]…as we know from long history that includes the depressions of the 1890s and 1930s, the recession makes the political process even more vulnerable than usual to pressures from vested interests.[4]

5.7 The World Wildlife Fund was concerned that the recession should not be seen as buying us time compared with the required path:

> Our view is very strongly that this scheme should be implemented as soon as possible. However, I think the main consequence of the fixed price, the postponement for a year, and indeed the global recession buffer and the additional money for energy efficiency is that it will quite significantly mute the near term signal to foster transformational low emissions technologies, not just garden variety low emissions technologies like wind but really significant low emission technologies like geothermal, marine or very large scale solar.[5]

5.8 The deferral of the starting date was welcomed by many business representatives:

> We welcome the delay in the CPRS commencement date…[6]
>
> A start date of 2011 will allow resolution of the complex EITE process, improving Australia's prospects of getting the right policy both designed and legislated.[7]
>
> Intergen (Australia) welcomes…a deferred start date till 1 July 2011…[8]
>
> …the CPRS should not start operation until economic conditions return to normal and there is a greater probability of this occurring by mid-2011.[9]

5.9 However, some business representatives were critical of the delay:

> A delay to the start date has the simple effect of delaying commitments to low emissions investments.[10]

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4 Professor Ross Garnaut, *Proof Select Committee on Climate Policy Hansard*, 16 April 2009, p. 45.

5 Mr Paul Toni, World Wildlife Fund, *Proof Committee Hansard*, 29 May 2009, p. 62.

6 Leighton Holdings, *Submission 18*, p 1.

7 BP Australia, *Submission 19*, p 3.

8 Intergen (Australia), *Submission 11*, p 1.

9 Caltex Australia, *Submission 27*, p 2.

10 Hydro Tasmania, *Submission 25*, p 3.

> ...delaying the commencement of the Scheme will have significant disadvantages for both the liable entities covered by the Scheme, as well as the carbon market services sector who are critical in providing liquidity.[11]

5.10 The Department of Climate Change also noted the impact of the crisis on some businesses' ability to prepare for the scheme, given the additional resources required to survive the recession:

> In terms of deferral, some businesses had raised a question of preparedness in advance of the scheme, but that was also partly in the context of the global financial crisis, because a number of firms were essentially saying that it was difficult for them to allocate additional time to those issues in the context of the current economic circumstances.[12]

5.11 Most witnesses and submitters who argued for a delay in the scheme were focussed on factors other than the global recession, including the importance of waiting for an international agreement to be reached, the damage that a premature start may have on Australian exporters' international competitiveness or the perceived deficiencies in the proposed scheme.

Committee View

5.12 The Committee acknowledges concerns that the global recession means that an early implementation of the CPRS may place undue pressure on some businesses. However the Committee feels that the crisis does not diminish the need for the implementation of the CPRS's comprehensive and ambitious mitigation strategy in the near future.

Business certainty and timing of the legislation

5.13 What is relevant for businesses making long-term investment decisions is not the timing of when the scheme starts but the rules that will govern the scheme over the medium- to long-term. For this reason, even if it is accepted that the global financial crisis is a valid reason for deferring the starting date, many business representatives called for the legislation to be passed in 2009:

> …certainty about the timing and the rest of the details of the CPRS were essential to enable business to plan for and respond to the impacts of the CPRS.[13]

> BP continues to support the case for policy action and certainty around climate change: until energy producers and consumers know and pay the cost of carbon, the uncertainty associated with planning and investing in the

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11 Carbon Markets and Investors Association, *Submission 34*, p 3.

12 Mr Brian Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 7.

13 Ms Maria Tarrant, Business Council, *Proof Committee Hansard*, 22 May 2009, p. 19.

> transition to a low carbon economy will remain high…we believe that the Government has largely 'got it right' with respect to many of the emissions trading design issues. [14]
>
> We support passage of the legislation this year...our members say that uncertainty is disruptive to business planning and is causing investment to be withheld.[15]
>
> We note that after significant debate over many years, both the current Government and its predecessor reached the conclusion that a cap and trade scheme was the best way forward...The longer we wait to address climate change, the more it will cost in the long term and the less flexibility Australia will have to transition to a lower-emissions economy when we do decide to start. We would like to see legislation passed to effect this cap and trade regime as soon as possible to address the continuing uncertainty for business, particularly in relation to capital intensive investment decisions.[16]
>
> …the Shergold report, which said that waiting until a truly global response emerges before imposing an emissions cap will place costs on Australia by increasing business uncertainty and delaying or losing investment.[17]
>
> We encourage the Government and opposition parties to move forward with the legislation by resolving the serious outstanding issues and complexities and passing the Bills.[18]
>
> Uncertainty in the regulatory framework is hindering investment decisions.[19]
>
> IGCC supports the introduction of the CPRS and supports its early passage through the parliament…Until a clear start date for emissions trading is set by the parliament, both debt-financing arrangements for these emissions-intensive assets and companies, and investment activities to support them will be delayed.[20]

5.14 One counterargument is that, to the extent the legislation is predicated on there being an international emissions trading scheme, it may be better to wait until after the Copenhagen Conference, or beyond, when more may be known about the design of other countries' schemes.

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14 BP Australia, *Submission 19*, pp 1-2.

15 Mr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 29 May 2009, p. 13.

16 Origin Energy, *Submission 32*, p 1.

17 Mr John Connor, *Proof Committee Hansard*, 29 May 2009, p. 57. The former government's Prime Ministerial Task Force on Emissions Trading (the 'Shergold report'), 2007, concluded 'However, waiting until a truly global response emerges before imposing an emissions cap will place costs on Australia by increasing business uncertainty and delaying or losing investment. Already there is evidence that investment in key emissions-intensive industries and energy infrastructure is being deferred' (p. 6).

18 CSR, *Submission 6*, p 1.

19 CO2 Group, *Submission 37*, p 2.

20 Investor Group on Climate Change, *Submission #*, p 1.

5.15 The Department of Climate Change disagreed with this view, arguing that the Copenhagen agreement will not be:

> … predicated on a particular view of a way mitigation is carried out at least uniformly in the rest of the world. It is predicated really on the view that, to the extent that Australia will take on emissions reductions commitments, it is desirable to use a mechanism that is the lowest possible cost way of achieving those emissions reductions.[21]

5.16 Other witnesses agreed that the discussions at Copenhagen will centre on targets, not the design of schemes. There is therefore no reason to delay legislation on aspects of the scheme other than the targets.

> We are not going to have any more insight about the optimal design of our domestic scheme as a result of the outcome at Copenhagen.[22]

> …we ought to, and we can, design a system that accommodates the range of possible outcomes from Copenhagen and subsequent international forums…[23]

5.17 Professor Ross Garnaut explained to the Committee his view that even before the Copenhagen Conference, it is clear that the direction in which the rest of the world is heading is towards a cap-and-trade emissions trading system (ETS):

> … it is very clear the way the Europeans are going. They are putting a lot of effort into cleaning up their ETS…There is no doubt where Europe is headed… The [United States] congress is now headed towards a cap and trade system and ETS… Japan and Korea will be heading that way. The main developed countries will be heading that way.[24]

5.18 The Committee notes that there had been claims that there was inadequate time to prepare if the legislation passed in 2009 envisaged a starting date in July 2010. On the same logic, delaying passing the legislation until 2010 would cause problems in meeting a July 2011 starting date.

Credibility at Copenhagen

5.19 The other main argument for passing the legislation soon is to bolster Australia's credibility at Copenhagen:

> …with respect to the international negotiations, Australia going to Copenhagen with a scheme capable of delivering large emissions reductions will have an impact on the international negotiations which,

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21 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 4.

22 Dr Brian Fisher, *Proof Committee Hansard*, 29 May 2009, p 48.

23 Mr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 29 May 2009, p 15.

24 Professor Ross Garnaut, *Proof Committee Hansard*, 22 May 2009, p. 15.

> through that process, leads to an outcome in terms of potential global emissions.[25]
>
> …passing this legislation now will be of assistance. It will send important signals to the international negotiations that an advanced country can actually tackle these elements.[26]
>
> …the proposal to delay the vote on the emissions trading scheme until next year would weaken Australia's negotiating impact at the crucial UN talks in Copenhagen in December.[27]

5.20 It could be argued that it is particularly necessary for Australia to have legislation already passed, rather than just promised, as Australia could be viewed as having 'form' for not implementing agreed measures. After successfully negotiating a very favourable target at the Kyoto negotiations, Australia did not ratify the treaty (until a decade later).

5.21 The main counterargument is a claim that Australia is so unimportant that anything it says or does will be ignored:

> …we are a small player here. We are one per cent of emissions and we have about that same sort of level of influence worldwide... Not only are we relatively trivial… Certainly, when I have visited overseas and talked about Australia's climate policy nobody has known anything about it. We really do not count.[28]

5.22 The Committee found more convincing the evidence from other witnesses that what Australia says and does will matter. For example, Professor Ross Garnaut, who in addition to being a distinguished economist is a former ambassador to China, said:

> Australia in isolation will have a significant effect on the global discussion of climate policy which will affect global climate… it is a fact of political science and economic science that what Australia does is relevant to a global agreement.[29]

5.23 Daniel Price, an expert on electricity markets, gave an example of how Australia can be very influential in energy policy reforms:

> Australia was in fact a year ahead of the UK in spot electricity markets… I know from my own experience that there has been a conga line of advisers

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25 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 8.

26 Mr John Connor, Climate Institute, *Proof Committee Hansard*, 29 May 2009, p 54.

27 Mr Owen Pascoe, Australian Conservation Foundation, *Proof Committee Hansard*, 29 May 2009, p 68.

28 Dr Alan Moran, Institute of Public Affairs, *Proof Committee Hansard*, 22 May 2009, pp 30 and 34.

29 Professor Ross Garnaut, *Proof Committee Hansard*, 22 May 2009, p. 16.

> coming to Australia over the last decade to see how we have gone about doing that. So Australia can play an important policy leadership role.[30]

5.24 He also commented that the global press had reported Australia delaying the start of the CPRS scheme:

> Very interestingly, the delay was actually reported in newspapers in China, Japan, Korea and also in Europe. It was relevant to the international press…[31]

5.25 Among the advanced economies Australia ranks in the top five emitters, behind only the US, European Union, Canada and Japan. Furthermore, as the largest per capita emitter in the OECD, Australia's stance will be more closely watched than its share of global emissions might suggest.

The transitional fixed-price year

5.26 The final CPRS legislation introduced by the government includes a transitional price cap of $10 for the compliance year beginning July 2011 (see Table 5.1).

5.27 The *Garnaut Review* advocated stating with a fixed price, albeit twice as high:

> During the transition period, permits should be sold by the independent regulatory authority at $20 per tonne…[32]

5.28 The Australian Industry Group does not believe that the certainty created by the $10 price cap will influence investment decisions:

> The substantial incentive for investment in renewable energy is the long-run price curve for carbon. It is not really what the price will be in 2011-12 because no-one seriously makes an investment looking only at that term. We are talking about investments that live for 20-plus years. If anyone looks at that price curve, that is what the key driver of renewable energy will be and that is why even the renewable energy target scheme is proposed to be phased out, because it is recognised that that is the driver of investment in renewable energy… One-year price caps' impact on that is very much at the margin.[33]

5.29 The WWF was far from strong in their support of the fixed price aspect of the Government's changes:

> **Senator EGGLESTON**—Some people were a bit critical of the fact that there will be an unlimited number of permits issued at a fixed price of $10

30 Mr Daniel Price, Chief Executive, Frontier Economics, *Proof Committee Hansard*, 22 May 2009, p. 35.

31 Mr Daniel Price, *Proof Committee Hansard*, 22 May 2009, p .35.

32 *Garnaut Review*, p 350.

33 Mr Peter Burn, *Proof Committee Hansard*, 29 May 2009, pp 23–24.

per tonne for the first year… What do you say about that? Would you rather see auctions instituted immediately?

Mr Toni—In an ideal world I would. As I said, the WWF is supportive generally of the proposals that the government has put…[34]

5.30 The Australian Conservation Foundation:

…oppose a low fixed starting price of carbon at $10 per tonne. We think the market should be operating fully and we support a market operating from 2010. So, no, we do not think a fixed price for permits is the way to go. Certainly we should allow the strengthening mechanism to operate and to provide that carbon pricing. We need to encourage investment in clean energy and energy efficiency. A $10 carbon price really does not provide the incentive that you need to see off the mark.[35]

5.31 Treasury's modeller has said that:

…the one-year delay is unlikely to significantly change the results [of the economic modelling] over the average to 2020.[36]

Impact on Revenue

5.32 Some witnesses expressed concern about the impact of the price cap on revenue. Environment Business Australia's view is that:

Well, firstly, if all the permits in the CPRS were auctioned and that money hypothecated depending on whose analysis you use, that would create anywhere between $14 billion and $20 billion a year.[37]

5.33 The revenue raised in the first year could be as little as half what was originally anticipated because of the price cap (Table 1.1). This reduces the revenue available to the Government for household assistance. However, the lower assistance should be offset by similarly smaller increases in prices for household items such as electricity as a result of the lower carbon price.

Committee View

5.34 The Committee feels the $10 price cap is an appropriate transitional mechanism which will allow for the early introduction of a carbon price and then appropriate market based price flexibility once the results of the Copenhagen negotiations are known.

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34 Mr Paul Toni, *Proof Committee Hansard*, 29 May 2009, p. 64.

35 Mr Owen Pascoe, *Proof Committee Hansard*, 29 May 2009, pp 68 and 73.

36 Ms Meghan Quinn, Treasury, *Proof Committee Hansard*, 22 May 2009, p. 8.

37 Ms Fiona Wain, *Proof Select Committee on Climate Policy Hansard*, 15 April 2009, p. 47.

Chapter 6
Conclusions

6.1 This report has concentrated on the changes to the CPRS since the exposure draft. However, as the committee also received evidence on the CPRS more broadly, it may be useful to summarise the Committee's overall view of the problem of climate change and how the CPRS addresses it.

The global challenge of climate change

6.2 The Committee believes the world should act to limit the concentration of greenhouse gases in the atmosphere. This is not an article of faith. It is a matter of prudent risk management. The earth is warming. If no action is taken, the overwhelming majority of expert scientific opinion holds that average temperatures will rise further, almost certainly leading to further changes in the global climate with severe consequences for humanity and terminal consequences for many other species, but that this can be limited if anthropogenic greenhouse gas emissions are restricted.

6.3 The Committee sees no reason to question the judgement of the national academies of science of all the world's leading countries on this matter.[1] It also notes that none of the witnesses appearing before it, even those most critical of the CPRS, argued that the science was wrong.

6.4 It is still not completely impossible that these scientific experts are misguided. But it would be folly to *assume* they *must* be wrong. Even if there were only a modest chance that the scientists are right, a prudent approach is to take out some insurance by acting now to reduce global emissions.

6.5 The most important action to take is to correct the global market failure that has led to excessive emissions of greenhouse gases. This is that for most of human history those parties responsible for greenhouse gas emissions have not had to pay for the consequences of them. This has led to a 'tragedy of the commons' on a global scale. Putting an appropriate price on these emissions, which can be done in a number of ways, is an effective response to the problem. Economic theory suggests it should be the lowest cost means of addressing the problem.

6.6 Tackling climate change has been described as 'a diabolical policy problem'[2], not only because it requires a global solution, but because of the intertemporal aspect. There will be costs, albeit modest, incurred by this generation to avoid much greater costs for future generations.

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1 The joint statement by the academies, led by the Royal Society, can be found in *Science*, 18 May 2001, p. 1261.

2 *Garnaut Review*, p xviii.

6.7 The Committee believes that the welfare of these future generations matters and should be taken into account in forming current policy. It notes that for some submitters, this view is reinforced by religious convictions:

> The Uniting Church's commitment to the environment arises out of the Christian belief that God, as the Creator of the universe, calls us into a special relationship with the environment – a relationship of mutuality and interdependence which seeks the reconciliation of all creation with God. We believe that God's will for the earth is renewal and reconciliation, not destruction by human beings.[3]

Australia's role in limiting climate change

6.8 Australia should play its 'fair share' in this global endeavour. As the Senate Economics Committee commented recently:

> Indeed, as one of the world's highest per capita emitters of greenhouse gases, one of the world's wealthiest countries, one of the major beneficiaries of past greenhouse gas emissions, one of the countries best endowed with renewable energy sources and one of the countries that would suffer most from further climate change, there is a strong case that Australia should be willing to make a more than proportionate contribution to this global effort.[4]

6.9 There is now broad political agreement that Australia's contribution to a global agreement that is likely to limit temperature rises to 2 degrees should be at least around a 25 per cent reduction in annual emissions from 1990 to 2020. A 25 per cent reduction in the context of a global agreement is the policy of the Government and the Opposition. The Australian Greens and Senator Xenophon want to do more.

What type of scheme?

6.10 While there is an important role for complementary measures, the primary way that Australia should limit its emissions is by establishing a price on carbon. This could be done by various types of emissions trading schemes or carbon taxes or hybrids.

6.11 The Committee notes that there has already been exhaustive analyses of these alternative schemes, and a consensus established preferring an emissions trading scheme over a carbon tax or hybrid measure.

6.12 For example, the Howard Government's task force concluded:

> Of the market-based instruments, emissions trading should be preferred to a carbon tax. Emissions trading will ensure that the policy focus remains on the ultimate environmental objective of reducing the output of greenhouse

3 Uniting Justice Australia, *Submission 5*, p 1.

4 *CPRS ED Report*, p 1.

> gases. It is also likely to be a central part of the emerging global response to climate change.[5]

6.13 The *Garnaut Review* for the current government concluded:

> In Australia's circumstances, a well-designed emissions trading scheme is superior to a carbon tax.[6]

6.14 Some people may state a preference for a carbon tax, either because in its textbook form it is simpler, or just because a further investigation would be the pretext for further delaying the introduction of any scheme. However the Committee agreed with the majority of witnesses that it remains preferable to stay with the cap-and-trade model:

> Our investigation of carbon tax is that the simplicity benefits are very much overstated. You have exactly the same measurement problems, exactly the same reporting issues, exactly the same issues involved as for trade-exposed, emissions-intensive industries and indeed trade-exposed businesses generally. Much of the complexity revolves around measurement and reporting and the majority of the complexity revolves around the issues that would be common to a carbon tax or an emissions trading scheme.[7]
>
> …there is nothing simpler about a carbon tax than what we actually have in terms of an emissions trading scheme. If you look at the details of the bills before us, the vast majority of the bills would have to cover issues which you would have to cover in a carbon tax. So fundamentally the issue of who would be a liable party, the way in which emissions would be monitored, reported and verified, the extent to which you would provide any exemptions or removal of liability, all those questions would arise under a carbon tax as would apply under an emissions trading scheme.[8]

6.15 The arguments about the relative merits of a carbon tax and ETS have been discussed in the series of reports and inquiries. The Committee has not seen any evidence that would lead it to suggest that this issue needs to be examined yet again. The main piece of new information since the earlier inquiries is that other countries introducing a carbon price have mostly chosen to do so using a cap-and-trade emissions trading scheme rather than a carbon tax or other model.

6.16 Nor will the negotiations at Copenhagen on national targets provide any further guidance on the choice between a carbon tax and an ETS (see Chapter 5). While negotiations are proceeding on the exact form of the ETS in the United States, it seems clear that a carbon tax is already off the table there.

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5 Prime Ministerial Task Force on Emissions Trading, *Final Report*, (the 'Shergold report'), 2007, p. 9.

6 *Garnaut Review*, p 311.

7 Mr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 29 May 2009, p 16.

8 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p 4.

The costs of acting or not acting

6.17 The *Stern Review*, still the major economic study on the topic, compared the short-term costs of taking action to reduce global greenhouse gas emissions with the long-term costs of allowing climate change to take its course. Its conclusion was that, if you care about future generations, there is a clear case for action:

> Using the results from formal economic models, the review estimates that if we don't act, the overall costs and risks of climate change will be equivalent to losing at least 5% of global GDP each year, now and forever. If a wider range of risks and impacts is taken into account, the estimates of damage could rise to 20% of GDP or more.
>
> In contrast, the costs of action – reducing greenhouse gas emissions to avoid the worst impacts of climate change – can be limited to around 1% of global GDP each year. [9]

6.18 The *Garnaut Review* looked at similar issues from an Australian perspective. It concluded:

> Mitigation on the basis of 550 [ppm atmospheric concentration of CO_2e] objectives was judged to generate benefits that exceeded the costs. Mitigation on the basis of 450 was thought to generate larger net benefits than 550.[10]
>
> The costs of well-designed mitigation, substantial as they are, would not end economic growth in Australia, its developing country neighbours, or the global economy. Unmitigated climate change probably would.[11]

6.19 The Treasury modelling had a narrower focus. It concluded that introducing the CPRS could shave around 0.1 per cent off annual economic growth, but this would still imply a 60 per cent increase in real per capita incomes by 2050.[12] Such a small reduction in economic growth is well below plausible estimates of the costs of allowing unchecked climate change.

6.20 The conclusions of the modelling is now accepted by the business community:

> We agree with the issue that the costs of not acting on climate change at a global level are greater than the cost of acting on global climate change. I do not think very many people seriously dispute that.[13]

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9 *The Economics of Climate Change: the Stern Review*, Cambridge University Press, 2007, p xv.

10 *Garnaut Review*, p xxv.

11 *Garnaut Review*, p 268.

12 Treasury, *Australia's Low Pollution Future: The Economics of Climate Change Mitigation*, October 2008, p. xi.

13 Mr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 29 May 2009, p 17.

The employment implications of the CPRS

6.21 The main argument put by opponents of the CPRS during this inquiry was its alleged adverse impact on employment.

6.22 The Minerals Council of Australia, in its evidence to the committee and in the media more generally, drew on modelling it had commissioned from Dr Fisher from Concept Economics to make the following alarmist claims:

> Carbon plan will cause jobs carnage … a steady drain of jobs out of the industry and out of the regional communities that depend on them.[14]

> The Concept Economics modelling shows that 23,510 direct jobs will be lost…[the CPRS] will eliminate jobs.[15]

6.23 However, as was pointed out to the Committee:

> Even if you have the modelling that I think was reported by the Minerals Council in the paper today, which talks about there being an aggregate effect and which talks about a loss of jobs, you have to understand that that does not necessarily imply that employment in absolute value is going down; it is just that the growth of employment is lower than it would have otherwise been.[16]

6.24 Earlier evidence from the Council implied that, in the business-as-usual case, the mining sector would have employed an additional 80,000 workers by 2020.[17] So even taking the modelling results at face value, after the introduction of the CPRS, there would be an increase of over 50,000 jobs in mining. Pushed on this point, the Minerals Council conceded:

> …we are not suggesting this is scorched earth. We know we are going to continue to grow.[18]

6.25 Downplayed by the Minerals Council, and ignored totally in their calculations of employment multipliers, are the increases in jobs in other parts of the economy. Many of these would be 'green jobs', such as producing renewable energy or

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14 Mr Mitch Hooke, Chief Executive, Minerals Council of Australia, *The Australian*, 22 May 2009, p 12.

15 Minerals Council of Australia, Media Release, 22 May 2009.

16 Mr Daniel Price, Managing Director, Frontier Economics, *Proof Committee Hansard*, 22 May 2009, p 36.

17 Mr Mitch Hooke, Chief Executive, Minerals Council of Australia, *Proof Select Committee on Climate Policy Hansard*, 22 April 2009, p. 27. Mr Hooke from the Minerals Council described the 'business as usual' case in the modelling as 'pretty damned close' to this; *Proof Committee Hansard*, 29 May 2009, p 50.

18 Mr Mitch Hooke, Chief Executive, Minerals Council of Australia, *Proof Committee Hansard*, 29 May 2009, p 51.

retrofitting buildings to make them more energy efficient. Like mining jobs, a large proportion of these will be located in regional Australia.[19]

The implications of not passing the CPRS

6.26 Delaying action is not economically responsible. Rather, delaying action will have a range of negative effects on the Australian economy, including deterring investment decisions and delaying business planning decisions where the price of carbon is a feature of those decisions.

6.27 In 2007, the *Shergold Report* expressed the fear that 'waiting until a truly global response emerges before imposing an emissions cap will place costs on Australia by increasing business uncertainty and delaying or losing investment.'[20] Evidence before the committee indicates this fear was fully warranted.

6.28 Business is fully cognisant of these difficulties, understands that they affect a wide range of both low-carbon and emission intensive industries, and expects the Australian Parliament to take action to resolve them this year:

> The issue that we face is that there is a strong political will and popular will to have Australia act on climate change. In view of that we assess that business needs to know for investment certainty reasons and business planning reasons—it needs to get a better picture of what that policy direction will be in order to make investments. This applies in for example the renewable area; it applies in the electricity generation area; it applies in a whole lot of areas … Our position is that we ought to have legislation this year.[21]

6.29 Emission intensive industries need the benefit of a framework within which they can acknowledge their carbon liabilities in order to move forward. In particular, the business community is concerned that a failure to act could have adverse implications for the security of Australia's electricity supply:

> We think that in order to secure ongoing electricity supply in Australia we need to make investments very soon. That has been quite apparent for some time.[22]

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19 Also ignored in the modelling commissioned by the Minerals Council are the jobs created by the payments to households in excess of the increase in their electricity and gas bills. Slower growth in the minerals sector is also likely to be associated with an exchange rate depreciation (the 'Gregory thesis' in reverse) which will increase rural and manufacturing exports and hence employment in these industries.

20 Prime Ministerial Task Force on Emissions Trading, *Final Report*, (the 'Shergold report'), 2007, p. 6.

21 Mr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 29 May 2009, p 15.

22 Mr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 29 May 2009, p 17.

6.30 Those with an interest in the development of low carbon industries are also concerned that business opportunities will be missed if the Australian Parliament fails to provide a framework to guide investment decisions in those industries:

> In many ways, if Australia does not get on board this train soon, we will be left behind. Our tragic history is one of coming up with the good ideas, but allowing that to go overseas for jobs and profit. We have seen that in solar technology and other technologies.[23]

6.31 The dangers of uncertainty for business were clearly identified by the Australian Bankers' Association's late submission to the committee:

> Climate change has considerable economic, social, environmental and business risks. Continuing uncertainty is disrupting the efficiency of existing markets as well as creating difficulties with regards to financing terms and investment decisions. Australia needs leadership and early action to provide business, investment, operational and market certainty. It is important for Australia to take action now and minimise the impacts of uncertainty.[24]

6.32 The Australian Bankers' Association also clearly identified business opportunities that will be lost if action is not taken now:

> Climate change also presents considerable opportunities. Trading, product creation and ancillary services (including risk consulting, funds management, legal and accounting) should be developed as export services regionally and globally... It is important for Australia to take action now and take advantage of the opportunity to position itself as a 'carbon hub' within the Asia-Pacific region.[25]

6.33 Ongoing uncertainty about how carbon will be priced will have a deadening effect on our industrial innovation and competitiveness. Australia will lack a coherent framework to guide the economy through the transition to a low carbon economy. Rewards could be distorted – industries of the future will struggle to get off the ground while those that must adapt will put off essential changes.

6.34 The alternative is to give Australian industry every opportunity to adapt swiftly and seamlessly to the reality of a carbon-constrained future by encouraging and supporting industry to continue to improve its performance in relation to emissions and to take advantage of emerging opportunities in a carbon-constrained environment, while maintaining its competitiveness.

6.35 If the CPRS is not passed, the problem of climate change will not go away. It just means that second-best, more costly, measures will have to be adopted to meet any targets to which Australia agrees at Copenhagen and/or more drastic cuts will have to be made to emissions at a later date:

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23 Mr John Connor, Chief Executive Officer, The Climate Institute, *Proof Committee Hansard*, 29 May 2009, p 53.

24 Australian Bankers' Association, *Submission 45*, p 4.

25 Australian Bankers' Association, *Submission 45*, p 4.

> One of our fears is that there will be a further proliferation of other regulatory measures if a scheme is not introduced.[26]

6.36 The Committee understands that some environmental groups do not regard the CPRS as going far enough. But it asks them not to, in Voltaire's words, 'make the perfect the enemy of the good'. Rejecting the CPRS will not lead to the passing of a much stricter scheme – it will lead to a less effective approach to meeting the Government's targets. And it will weaken Australia's ability to push for serious action at Copenhagen.

6.37 If the case is made for stronger targets, and there is international will to pursue them, then under regulations – or if necessary by amending the legislation – the targets under the CPRS can then be tightened. But if there is no CPRS, and no targets, there is nothing to be tightened and no response to be made.

Recommendation 1

6.38 The Committee recommends that the Senate pass the bills.

Senator Annette Hurley

Chair

26 Mr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 29 May 2009, p 21.

Coalition dissenting report on the CPRS changes with additional comments by Senator Joyce, Leader of the Nationals in the Senate on behalf of the National Party

Foreword

Coalition Senators firstly wish to express their objection to the impossible timetable imposed by this government for this Inquiry and also to voice their strong protest at the biased list of witnesses the Government called to appear. As a result the Coalition Senators on the Senate Economics Committee regard this Inquiry as a farce.

The amended Carbon Pollution Reduction Scheme (CPRS) Bills were referred to the Legislation Committee on 14 May 2009 with a requirement to report to the Senate on 15 June 2009. The month overlapped the two-week period of Senate estimates, widely known to be the most intensively busy period of the Senate year. Furthermore, hearings were concluded on 29 May before the closing date for submissions had been reached on 4 June.

The Economics Committee could not expect to conduct a rigorous assessment of these changed Bills with these deadlines.

On the choice of witnesses to give evidence, Coalition Senators' efforts to have input into the witness list was stonewalled by the government majority on the Committee. The government appeared only reluctantly interested in balance. The Coalition submitted a list of representative groups from industries and agriculture who will be adversely affected by the introduction of the Rudd/Wong CPRS and whose input we considered essential to the deliberations of this Inquiry, but save two changes, our efforts to have this Inquiry hear a range of views were blocked.

However the Rudd government will not prevent the Coalition from continuing the robust debate on this matter of vital importance to the Australian public.

Introduction

The Coalition believes a badly designed scheme is worse than no scheme at all.

As a country producing only 1.4 per cent of the world's CO2 emissions, there is no Australian solution to climate change, there is only a global solution. The design of any Australian emissions trading scheme (ETS) must be responsive to what is happening in other countries.

Australia and the United States are countries with similar economic profiles yet there are stark differences emerging between the Rudd government and the legislation

endorsed by US President Obama. This is a wake up call for Mr Rudd and Senator Wong.

Amendments made in May to the draft US emissions trading legislation, include very specific provisions providing 100 per cent protection to US export and import competing industries in any future ETS until 2025.

What is more, the draft US Bill now says that a reduction in protection of these industries will only occur after 2025 when more than 70 per cent of global output for that sector is produced or manufactured in countries that have a scheme equivalent to that operating in the US.

Australia has to look to the US proposals and any global agreement before committing our people and our industries to this monumental shift. Introduction of a flawed design will seriously damage the competitive position of many of our industries, and see Australian jobs, investment and CO2 emissions being exported to countries where no price is being imposed on carbon.

Overview

The Coalition believes climate change is best tackled from a position of economic strength.

Mr Rudd promised before the election to introduce an ETS which would produce deep cuts in CO2 emissions, but would not disadvantage Australia's export and import competing industries. Mr Rudd's other election promises included establishing an ETS by 2010, ratifying the Kyoto Protocol and setting a target of 60 per cent reduction by 2050 from 2000 levels.

Coalition Senators are of the opinion the government's immensely complex ETS will damage our export and import competing industries, cost thousands of jobs, stifle investment and yet not produce any meaningful reductions in CO2 abatement.

In the opinion of Coalition senators, to rush the introduction of this scheme without knowing the outcome of the December 2009 global climate change summit in Copenhagen, without knowing what President Obama will do and without knowing the impact of the global financial meltdown on our real economy is reckless in the extreme.

With the economy in the greatest downturn since the Great Depression this is not the time to proliferate undue costs for major Australian industries.

Global industries

If Australia moves out of step with the world, any cuts in Australia's emissions will not necessarily have a global impact. There may be adverse consequences on emissions.

For example, Australian aluminium and zinc production pumps out 50 per cent to 60 per cent less CO2 than similar industries in China.

Another example is that with LNG industries alone, the proposed scheme will perversely prevent up to 180 million tonnes of CO2 (one third of Australia's emissions) being avoided each year because of gas projects that won't go ahead. For every tonne of greenhouse gas associated with the production of LNG in Australia, between 4.5 and 9 tonnes are avoided in the Asia-Pacific region when this gas is substituted for coal in generating electricity. LNG is part of the global solution, not part of the problem yet the scheme significantly penalises LNG exports.

Coalition Senators recognise these outcomes make no sense and urge the Rudd government not to legislate an Australian ETS out of step with the global objective.

Flaws in government CPRS

Treasury Modelling

The Treasury modelling was months overdue, did not factor in the global financial crisis, and made the critical assumption that the entire world would sign up to be part of any scheme.

The Treasury was not permitted to model any alternative scenarios or methods. The exercise has been self-serving, misleading and irresponsible.

The design of the Rudd government scheme assumes that our major competitors will move to put in place a major new tax on carbon across their economies, including their export and import competing industries, in the early years. The government assumed the US would begin an equivalent scheme by 2010, China by 2015 and finally India by 2020.

In the opinion of Coalition Senators this is extremely unlikely to eventuate.

Costs

The Rudd Scheme involves generating permit revenue of nearly $13 billion from year one – a massive increase in taxation.

This will see a huge administration set up to churn these billions of dollars back through the economy, with the government picking who gets compensation and who doesn't.

In the years ahead no new resource projects in Australia will get off the ground without companies coming cap-in-hand to get a quota of free permits from the government to make their investment competitive. It will foster a nanny State, mendicant attitude.

In many cases the best placed companies to develop and fund the migration to cleaner energy processes, including renewables, are the big emitting companies. The CPRS, by putting a hole in the balance sheets of these companies, will stifle this activity.

On top of this the Government has made little or no attempt to allow for the impact of the global financial meltdown on the capacity of companies – either administratively or competitively – to cope with the transition to one of the biggest structural changes in our history.

Even the ability of companies to source the finance to buy $13 billion worth of permits is highly problematic in the middle of the worst credit crunch in 80 years.

The Coalition believes the community has been given a totally false and misleading impression on the real costs of the CPRS by the government's misleading presentation of the Treasury modelling.

Regional Impacts

Research commissioned by the NSW Government into the regional impacts of the Government's scheme found that regional centres across Australia, such as Gippsland, Geelong, central-west Queensland, the Hunter Valley, central Western Australia, the Kimberley region and Whyalla / Port Pirie, would shrink by over 20 per cent under the Rudd government's scheme.

Work presented at the recent Farm Institute Conference showed that the average dairy farm will face a new annual indirect tax impost of $6,000 to $9,000, with no capacity to offset this cost.

Similarly, the beef and sugar industries will each see a $60 million tax passed back in the price they receive for their cattle and sugar cane.

The grains industry, a very low emitter, will face annual indirect costs of $ 500 million. This emissions tax would sit on top of tariffs faced by our grains industry.

The latest proposed US legislation, explicitly excludes agriculture from the cap but explicitly includes agriculture in the opportunities to develop offsets, as a means of creating a revenue stream for farmers.

This is a clear indication that the US is heading towards the development of a market-based scheme, in concert with voluntary, regulatory and incentive-based measures. Such possibilities have been totally ignored here in Australia in the frantic rush to get legislation before the Parliament.

Critical areas such as agriculture and Australia's huge commercial building sector are not in the scheme and are effectively ignored as sources of abatement.

The Rudd scheme involves a tax that indirectly and significantly hits the bottom line of these sectors, with no incentive to abate or achieve offsets.

Certainty

Providing "certainty to business" is one of the Rudd government's most repeated reasons for the passing of the legislation.

However, businesses have said they don't want the certainty of not being able to compete. They want a scheme which preserves their international competitive position.

Anglo Coal Australia CEO Seamus French has said that certainty was not preferable to getting the design right for business. "We don't want the certainty of a bullet," he said.

Nothing undermines certainty more than the bullying tactics that have been on display from the Rudd government in recent weeks when it has threatened business with the removal of any assistance under an ETS and attempted intimidation to get support for its badly designed model.

The government's arguments that its emissions trading legislation needs to be rushed through Parliament have been undermined by the Executive Secretary of the United Nations Framework Convention on Climate Change (UNFCCC), Yvo de Boer, who revealed that the UN does not require countries to have legislation in place before the Copenhagen meeting.

The Opposition has recognised the imperative is that Australia goes to this conference with a united position on targets, not a flawed scheme.

Changes to the CPRS announced 4 May 2009

The changes announced by the Rudd government on 4 May 2009 are nothing more than tinkering, largely arbitrary, with a flawed ETS likely to damage the economy. There is still no credible demonstration that the government's scheme is the most cost-efficient or effective way to reduce carbon emissions.

In our view the proposed changes make the government's scheme even more complicated and fail to address several of the key objections levelled by business and community groups, namely:

There is still no forecast of the near-term impact of the ETS on jobs and economic growth.

Australia's trade-exposed industries are at a disadvantage to their competitors, (although the disadvantage is less severe than in the original scheme).

There is still no assurance that overall emissions will be reduced by investment in complementary abatement measures such energy efficiency. The energy efficiency measures that the government has proposed are largely tokenism.

Australia's largest export earner, the coal industry, is still treated anomalously.

Productivity Commission

Coalition Senators believe the start date is less important than getting the scheme right.

Delaying the passage of the legislation through the parliament provides the Rudd government the opportunity to refer the design of their scheme to the Productivity Commission to assess whether it meets the nation's economic and environmental objectives.

Such an assessment would provide an objective external assessment, free of political bias, of the proposed Rudd/Wong CPRS on the Australian economy.

Coalition Senators urge the government to refer the CPRS legislation to the Productivity Commission for an independent assessment.

Pearce Review

The Coalition has evaluated the Government's legislation, and its impact on jobs and emissions.

To assist our policy review the Coalition commissioned an independent review of the government's White Paper by the Centre for International Economics, a review which received nearly 50 submissions from industry and organisations.

The CIE report (Pearce Review) was released on 30 April 2009 and backs the Coalition assessment that the Government is rushing ahead with a scheme that will tax Australia's largest exporters and employers, damage their competitiveness and put jobs at risk, without any analysis of the immediate costs, without any analysis of alternative approaches, without considering the impact of the global financial crisis and without considering the actions or inactions of major competing countries.

The Pearce Review findings included:

- The proposition that the CPRS generates abatement at lowest possible cost has not yet been demonstrated;
- There is no clear understanding of the transitional costs of the CPRS and there is a risk that, if these are not properly understood, unexpected transitional costs may derail the policy;
- The non-trade neutrality of the CPRS poses a major challenge for a number of important industries — this non-neutrality brings no environmental benefit;
- The scheme potentially threatens the balance sheets in a number of key industries;
- It is not clear that the proposed CPRS will produce higher net benefits than will other available alternatives;

- At the very least, more consideration should be given to complementary energy efficiency measures; and
- Many of the major aspects of the CPRS have not been modelled and, therefore, neither have the tradeoffs inherent in particular design choices.

The Pearce Review also recommended that a Regulatory Impact Statement (RIS) should be prepared for the CPRS legislation. A RIS is required by the Australian government when a regulatory proposal is likely to have significant impact on business, individuals and the economy. Coalition Senators are surprised a RIS has not been carried out on the government's CPRS and consider it is essential that this be undertaken as soon as possible.

Senate Select Committee on Fuel and Energy

The Senate Select Committee on Fuel and Energy released its interim report on 7 May 2009 entitled 'The CPRS: Economic cost without environmental benefit." The report assessed the impact of higher petroleum, diesel and gas prices across the economy. In particular the report found:

- The proposed CPRS will be ineffective in reducing global emissions;
- The government has not addressed the concerns raised about the short and medium term impact of the CPRS on the economy and jobs;
- Australia's trade exposed industries will continue to be disadvantaged compared with their competitors (unlike in the much cited European ETS); and
- Many other flaws explored in some detail in the Select Committee's report have not been addressed.

Similarly, the Coalition Senators on the Senate Economics Committee had grave misgivings about the appropriateness of the extravagant Rudd/Wong CPRS model and recommended that the government go back to the drawing board and consider alternative models more appropriate for Australia's needs as a small nation generating only 1 per cent of world GDP and emitting a mere 1.4 per cent of global emissions.

The Rudd government has said Australia should play its "fair share" in this global endeavour. This raises the question of what is a "fair share" for Australia.

The Coalition Senators believe that a "fair share" for Australia should match the reality that Australia produces a very low proportion of world emissions and any Australian carbon emissions reduction scheme should be balanced and not zealously overcompensate for Australia's contribution to global carbon emissions at great cost to our economy and people's welfare.

Proposed amendments to the CPRS legislation

Given that the Coalition Senators' view is that the structure of any Australian carbon reduction scheme should be informed by the outcome of the Copenhagen conference,

there is little point in detailed discussion of the government's proposed amendments. However, it should be noted that the Coalition does support recognition of voluntary action and encouragement of the development of renewable energy sources, including solar power. This is because solar is one renewable energy source Australia is blessed with in abundance. Coalition Senators accepted the case made to limit the eligibility for inclusion of greenhouse gases emanating from landfill.

Coalition Senators are surprised that the government did not heed the amendments proposed by Griffith Coal to correct a disadvantage the legislation imposes on the Western Electricity Market (WEM). The WEM is largely gas dependent in comparison with the Eastern Electricity Market (the so called "National Electricity Market" in the parlance of Treasury). Coalition Senators recommend that the government instruct Treasury to reconsider Griffith Coal proposed amendments to avoid WA producers being selectively disadvantaged.

Coalition Senators regard the evidence given by the Minerals Council of Australia at the hearings conducted in Canberra on May 29 as sending serious warning signals to Australia about the potentially devastating impact of the Rudd/Wong CPRS on the Australian economy.

The Minerals Council raised a number of issues about the impact of the proposed CPRS in the Australian economy which require answers, as is shown in the Hansard record of the May 29 hearings of questions put to Mr Hooke:

> Senator EGGLESTON—You also mention that China, Japan, our regional trading partners, and India are unlikely to introduce an emissions trading scheme, yet that is one of the fundamental predications on which this proposal by the government is based. For that reason, if these other countries do not come on board, it seems obvious that Australia will be bearing a higher cost from the Emissions Trading Scheme and the price of carbon if it cannot be traded off. Given that scenario, what do you think will be the impact on investment in Australia?
>
> Mr Hooke—We are operating in a global economy, the minerals sector globally is probably one of the most globally integrated sectors and there is no shortage of global resources; therefore, Australia has to be very careful that it does not get carried away by its own rhetoric about our comparative advantage in the endowment of natural resources. In addition, we have seen significant rationalisation and consolidation of the minerals industry globally over the last decade—so much so that the top five companies in any of the product sectors is doing somewhere between 40 and 80 per cent of the business and probably more of the inventory. That means that these guys will strategically deploy capital where there is the best opportunity to realise it.
>
> What Australia is doing, wittingly or unwittingly, is increasing the sovereign risk associated with those investment decisions. If we impose a tax or a price on carbon that, in effect, becomes a tax, because we do not have the technologies to adjust, if our competitors are not facing the same kinds of costs and if we saddle our industry with costs they cannot either adjust to or absorb, you do not need to be either a Philadelphia lawyer or an

> economist to know that they will move their activities to where they do not have those costs. That is known as carbon leakage. That may well be, in an economic sense, a most efficient way to go; but essentially, to correct one externality, we are intervening with another that goes straight to the bottom line if we do not have the technologies to adjust and if we do not have the profit to adjust. The day before yesterday, one of our member companies at the Minerals Week seminar put on the record that, had this scheme existed in the preceding five years, it would have knocked 65 per cent of their pre-tax profit and he made the statement that his headquarters in London would have shut down their operations here in Australia.
>
> Senator EGGLESTON— Are there any other specific examples of industries where you think companies might reconsider their future in Australia if this scheme is introduced as is?
>
> Mr Hooke—Across the minerals sector, there has been a lot of attention and focus on coal. But this is not just a coal story; this is across the board. The gold industry will be looking at a $700 million hit to the bottom line over five years. Then there is anybody who is in the business of smelting and refining across all of the minerals, which are emissions intensive activities. Much is made of the assistance to 'big polluters', but I would make the point that 90 per cent of Australia's minerals exports—and we are predominating exporting, as you know—will receive no shielding from the full impact of this scheme, while their competitors will face no impacts.

The Minerals Council presented a report by Dr Fisher of Concept Economics which suggested that the introduction of the CPRS could result in serious job losses in the mining sector of some 24,000 direct job losses and another 100,000 indirect job losses.

It was held by other witnesses that jobs lost in the minerals sector would be compensated for by the creation of so-called green jobs. However it was stated that such compensatory green jobs would be relatively lower paid that those in the mining sector. Senator Fisher questioned Dr Fisher of Concept Economics on this matter:

> Senator FISHER—Dr Fisher, drawing on your extensive experience in matters economic and indeed beyond our really important mining sector, given the prediction about job losses in the mining sector and the consequent damage to the mining sector, together with the views by others that there will be an increase in jobs in the green sector and a beneficial impact on the green sector as a result of the CPRS legislation, what is your view as to whether or not the economic benefits in terms of predicted jobs and so on to the green sector, should it eventuate, will compensate for the economic damage done by the CPRS across the rest of the economy?
>
> Dr Fisher—The answer to that can be short, but it is also long in the sense that what we have done in the modelling and what the Treasury has done is to make an assumption that, if we take the full economy, for every job that is lost in one place there will be another job of some description elsewhere. The high paid workers in the minerals industry, for example, will be displaced and that is what we have been talking about today, and in the long term there will be a job somewhere else in the economy. That is the way the

> modelling has been set up. But to make that work what both the Treasury and I have done in the national modelling is to allow the real wages of workers to fall. We have held total employment constant, but to allow that to occur we have allowed real wages to fall.
>
> What is happening here is that real wages have to be lower than they otherwise would have been to maintain everybody in a job. Nobody is being very forthcoming about that particular assumption. In the debate everywhere it has been dressed up as what is called model closure.
>
> Model closure is a technical term for the way in which you make these models work effectively.
>
> Senator FISHER—Both you and Treasury are saying that in order to stop job losses you are going to have to incur pay loss?
>
> Dr Fisher—Yes, reduce real wages.
>
> Senator FISHER—Keep your job by reducing your take home pay?
>
> Dr Fisher—That is correct.

At the hearings on 29 May 2009, Senator Joyce questioned Mr Price from Frontier Economics about the impact of the proposed CPRS on regional Australia:

> Senator JOYCE—I just want to talk about the regional issue there. The model still assumes full employment; therefore it assumes the transferability of the employment workforce from Mackay to building wind chimes in Nimbin.
>
> Mr Price—That is not to suggest, though, that these models do not actually indicate regional effects. Some studies that we did before were widely reported in terms of the regional effects of these types of schemes. Even if you have the modelling that I think was reported by the Minerals Council in the paper today, which talks about there being an aggregate effect and which talks about a loss of jobs, you have to understand that that does not necessarily imply that employment and absolute value are going down; it is just that the growth of employment is lower than it would have otherwise been. So, on the one hand, you have the government saying, 'Our modelling shows that employment will grow,' and, on the other hand, you have the Minerals Council saying that employment will shrink. They are actually saying the same thing but reporting different numbers, so you have to understand that. But, even if our aggregate employment stays the same under an emissions trading scheme, there will be regions which involve very carbon intensive activity which will be in significant decline.
>
> Senator JOYCE—Where are those regions?
>
> Mr Price—It is not hard to imagine: wherever there is major industrial activity.
>
> Senator JOYCE—Such as?
>
> Mr Price—Central Queensland, the Latrobe Valley, the Hunter Valley, the Kimberleys—anywhere that you have major energy using, particularly industry. Coalmining is an example. Of course—and I have said this before in this forum—if you did not have an adverse effect on those regions, the

> scheme would not work. You have to actually cause a reduction in those industries to achieve a reduction in emissions. It depends on what the government's policy objective is. That may make sense if they can manage the structural adjustment from one industry through to another and manage the flow of resources from, say, Central Queensland to South-East Queensland, where new jobs are found for the green industry.

Low income groups

Coalition Senators were concerned that low income groups would be subject to increasing costs of electricity and consumer goods on lower relative wages. Coalition Senators believe the organisations representing the low income sector of the community should reflect more deeply about the implications of the CPRS for the groups they represent. It is clear that those at the lower end of income scales in our society who will be most disadvantaged by the impact of Labor's CPRS.

Sadly, while compensation may be planned all too often it is those relatively powerless people at the bottom end of the income scale whose interests are compromised when conditions change.

Conclusion

The Coalition will offer bipartisan support to the government for the carbon abatement targets Australia takes to the Copenhagen climate change conference in December.

This means the government can go to the conference with a united Australian position in seeking a global commitment to addressing climate change. That united position is for an unconditional reduction in emissions of five per cent from 2000 levels by 2020, and a reduction of up to 25 per cent in the event of a comprehensive global agreement.

In light of the fact that the Copenhagen conference is only six months away, and the Obama Administration and US Congress are well advanced in finalising US legislation for an ETS, the Coalition believes that it would be premature to lock Australia into an ETS that is out of step with the rest of the world.

The Coalition therefore will move in the parliament to defer a final vote on the government's proposed ETS until after the Copenhagen meeting.

In order to enable immediate action on climate change, the Coalition proposes the establishment of a Government-authorised voluntary carbon market from 1 January 2010 based on the Chicago Climate Exchange. This would enable the immediate involvement of individuals and communities, agriculture and bio-sequestration, the commercial building sector, energy efficiencies by business, and other complementary measures in creating bankable offsets.

These voluntary measures will enable immediate action on achieving Australia's 2020 targets and will create an opportunity for individuals, communities and firms to help Australia deliver larger abatement than the government targets once a full scheme is in place.

The Australian Climate Exchange predicts that “at least five per cent additional reduction by 2020 could very easily and conservatively be achieved through voluntary measures.”

The government has already chosen to delay the effective start date of its own ETS to 2012. This is an appropriate acknowledgement of the current economic climate, and offers Australia a window to get our scheme right and ensure it does not export jobs, investment or emissions.

In particular, it is clear that the emerging Obama plan will offer 100 per cent protection for US export and import-competing industries until 2025. The Government's current plan would therefore leave many of Australia's most successful industries (and largest employers and taxpayers) at a crippling competitive disadvantage.

It is critical for Australia's treatment of these industries to align with the treatment received by their competitors.

The deferral in start date also offers an opportunity for the government to allow the Productivity Commission to assess the efficacy of its proposed scheme, and its impact on jobs, regions and agriculture if competing economies adopt comparable measures many years later than expected.

The Coalition will augment its support for emissions reduction targets with a significant renewable energy support package in the near future.

The Coalition's overall approach will allow Australia to take a unified commitment to emissions reduction to Copenhagen. It also enables an earlier start to emissions abatement and the potential to build on 2020 targets, via voluntary action. In the meantime it allows Australia to get its ETS right – saving tens of thousands of jobs and billions of dollars in investment by ensuring our scheme is in step with the rest of the world.

Additional Comments by Senator Barnaby Joyce, Leader of the Nationals in the Senate

My additional comments must be seen as a caveat on the concluding comments of the report.

The National Party believes that any agreement that Australia should sign up for must be fully assessed against the ramifications to our major exports which are based in regional Australia. Therefore, the support for a 5 per cent reduction would be conditional upon this effect, and support for any global agreement would have to be genuinely global, in a mechanism that was not disproportionately detrimental to Australia's economic position.

Our belief is that decisions regarding a CPRS go beyond sole focus on an ETS, as we see an ETS as one of a whole range of solutions encompassed as carbon pollution reduction schemes.

The current further investigations into the economic effect of carbon pollution reduction schemes, and the premise of their accountability as spelt out by such as Lord Monckton should be fully examined in the devising of future schemes.

All schemes should take into account the capacity of further science and further analysis being able to change the aspects of delivery of any package. It should absolutely be acknowledged that those who don't have the capacity to pass costs on will be the ones who have to pay the cost. After all subsidies are finished, the questions all Australian citizens have to ask themselves is "am I in a position to pass this cost on or do I have to pay the costs, and am I prepared to pay these costs in the long term, and does my nation have the capacity to carry these costs with its desires for other expenditure alternatives?"

The creation of an overhead is never a stimulant and the ETS in its current form is a definite overhead.

It also must be acknowledged that the current scheme regardless of what may be the public belief will do absolutely nothing to reduce global carbon emissions.

It is a political gesture and there is an imperative that the political house must be extremely sceptical of voting for poll-driven gestures. Otherwise we put our nation on a slippery slope of a whole range of possibly popular but not completely well founded ideas.

Senator Alan Eggleston
Deputy Chair

Senator Barnaby Joyce
Member

Senator David Bushby
Participating Member

Minority Report by Senator Nick Xenophon

Background: nature of the problem that we are trying to solve

1.1 Anthropogenic climate change presents us with the most pressing and complex policy problem that we have faced. It is pressing because the window of opportunity in which we have to take the sort of abatement action needed to avoid irreversible, dangerous and potentially catastrophic climate change is small; and, on the basis of the findings from the March 2009 conference in Copenhagen, is getting smaller. It is complex because it has all the features that policy, whether at a global or national level, usually struggles to deal with. These include the fact that abatement has large upfront costs, with benefits that accrue in a relatively distant future and with some degree of uncertainty; the need to provide for the development aspirations of poorer countries and the emissions trajectories entailed by these; the uneven spread across the globe of net benefits from abatement; and the potential for 'free rider' issues created by the fact that no one country stands to gain from abatement efforts in the absence of concerted action. These last two issues create what Professor Garnaut has accurately characterised as a diabolical prisoner's dilemma problem.[1]

1.2 This overall context must inform the design of an emission trading scheme in a country like Australia with its small, open economy. There is a sensible policy case, as well as a strong ethical one, for Australia to take early emissions reduction action in order to break the potential deadlock created by the prisoner's dilemma and uphold the sort of global co-operative agreement required to address global climate change. We need to be clear that the brutally honest position is this: in the short to medium term the success of our domestic policy (indeed, of all advanced countries) will be a function of the ability to get all countries (notably the large emitting developing countries) on board, without which there will be no prospect of addressing climate change. [2]

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[1] Garnaut, R., *The Garnaut Climate Change Review: Final Report,* (2008) Commonwealth of Australia, pp 287-290

[2] The imperative of global action, particularly for poorer countries, is underlined by David Wheeler in *"Another Inconvenient Truth: A Carbon-Intensive South Faces Environmental Disaster, No Matter What the North Does",* Center for Global Development, Working Paper Number 134, December

1.3 In taking such action, Australia needs to adopt a scheme that is credible internationally and sustainable domestically. International credibility will be to a large extent a function of the abatement targets Australia sets for itself. Domestic policy sustainability is to a large extent a function of adjustment costs, particularly in the short to medium term when there are likely to be significant gaps in emission reductions efforts globally. Policy sustainability has an economic dimension – imposing large adjustment costs on the economy with no prospect of incremental global abatement gain is simply not an efficient economic proposition. And this impacts on the political dimension of policy sustainability by eroding support for emissions reduction, particularly in a time of economic uncertainty.

What are the policy issues that should govern the design of a carbon pollution reduction programme?

1.4 Given this particular background, what are the particular issues to consider as important in designing a carbon reduction programme?

1.5 Clearly the overarching goal is **environmental** – the abatement of greenhouse gas emissions. This is largely contingent on establishing the appropriate incentives to bring about substitution in production and consumption from emissions intensive goods and services to ones that are less so, and to prompt behavioural changes in consumers and producers. Abatement will, fundamentally, be investment driven. Firms will need to invest in a variety of activities – whether in R&D, in implementing new process or selling different goods and services – as they respond to changes in input costs, relative prices and changes in consumer demand.

1.6 The second set of issues consists of **adjustment issues**, which impact directly on the issue of domestic policy sustainability discussed previously. Adjustment issues range from the income effects on households stemming from the introduction of a price on carbon, to the impact on asset values of what the Government has called 'strongly affected' firms. Issues related to carbon leakage and the loss of

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2007. Wheeler's modelling suggests that even if rich countries emissions were reduced to zero, current emissions trends in poor countries would still place the world on course for serious climate change impacts.

competitiveness are adjustment issues that relate directly to the global nature of the abatement task and the prospect that, in the short to medium term, countries like Australia will be implementing emission reductions ahead of others.

1.7 **Carbon leakage and competitiveness** cut to the heart of both the economic and political dimensions of sustainability. While the political is often emphasised, it is important to underscore the economic efficiency aspects of both these issues too. Carbon leakage is a net cost to the global economy – it imposes adjustment costs with little or no return in terms of global abatement. Competitiveness losses can also be a global cost (and not just specific to Australia) as well. This will arise if carbon reduction schemes cause the relocation of activity away from Australia, when that activity would have been located in Australia had there been a concerted global effort to reduce emissions. The implication is that the introduction of a price of carbon in some countries but not in others will cause a distortion to the global allocation of production along lines of comparative advantage.

1.8 The third set of issues consists of **governance issues**. These include the potential for policy capture. Capture could manifest itself in a number of ways including: manipulation of the scheme parameters and its implementation; or manipulation of some other area of government policy (such as trade policy) in response to the effects (or supposed effects) of the carbon pollution reduction scheme.

1.9 Given these policy issues, a carbon pollution reduction scheme will be judged on the grounds of whether it is:

- effective in managing these different concerns, and any trade- offs between them;
- efficient in managing these concerns at least cost;
- ethical in terms of managing various equity and distributional issues that are raised by these concerns.

Critique of the CPRS and government approach

A weak target

1.10 Against this backdrop is a critique of the Government's approach as set out in the CPRS. Perhaps the most commonly heard criticism of the scheme is the overall target range of 5-25% that has been set. That target range is largely a reflection of the adjustment costs that may be expected, but also of the peculiarly high cost nature of the scheme that has been chosen. In respect of the former, it is likely that the Government's own modelling has understated the costs, in the short to medium term, of adjusting to a carbon price. This in turn is a reflection of the fact that the type of Computable General Equilibrium (CGE) model uses a full employment rule as its closure rule - that is, the economy is always at or near full employment levels, and responds to a shock almost immediately. In other words, for example, retrenched workers in the Pilbarra or in Newcastle become insurance agents in Melbourne or Sydney overnight. Clearly, this is unrealistic, and while the full employment rule and its consequent results can be a useful guide to what happens in the long term, it simply assumes away some of the most pressing policy problems in the short term. Indeed, it is quite likely that the Government is aware of the limitations of its modelling and has thus chosen a cautious approach as a consequence.

1.11 Setting aside issues of modelling, concerns regarding adjustments costs are also warranted on account of the high cost nature of the cap and trade mechanism within the CPRS, as compared to alternatives. This point is explained in further detail below when intensity-based approaches are discussed. The main issue is that the cap and trade approach essentially acts as a penalty-only mechanism: it penalises all emitters as a function of their emissions intensity, but offers no direct reward to firms that cut emissions.

1.12 If we marry the high cost aspect of the scheme design to concerns about adjustment that may not be captured in the modelling, then a relatively modest target range is a predictable outcome. It does, however, raise the question as to whether a more ambitious target could be adopted if an alternative scheme design were available that would be more attractive in managing adjustment concerns because the scheme has lower cost properties. This would be desirable from an environmental perspective, and in terms of sending a more credible signal internationally (recalling

here that the overarching objective sought through the early implementation of a carbon reduction scheme is to sustain a co-operative international agreement).

Not one but many schemes

1.13 The CPRS is a combination of several mechanisms and initiatives. Ostensibly, its central feature is a cap and trade mechanism, though it would be more appropriate to refer to it as a "quasi-cap and trade" mechanism. Under a standard cap and trade scheme, the quantity of emissions is fixed and the cost of emissions (i.e. the price of permits) is allowed to vary. In the case of the CPRS, this fixed quantitative restriction is relaxed. If the permit price reaches a certain level ($40 per tonne), the Government will issue an unlimited number of permits – as Richard Denniss put it in a recent presentation, the Government will start printing permits as if it were the central bank of Zimbabwe printing cash.[3] The price cap, as well as banking and borrowing provisions and gateway provisions that provide flexibility for the Government to adjust the overall targets in the light of prevailing circumstances reflect a concern on the part of the Government both to cap the overall costs of the scheme, and to limit volatility in prices. This in turn is motivated by a concern regarding the adjustment impact of permit price rising to higher than expected levels, and an acknowledgement that untrammelled volatility in permit prices is undesirable because of the investment uncertainty this generates.

1.14 **Mitigating the transitional adjustment impact** of emissions trading also provides a central motivation for revenue recycling, which under the CPRS would be undertaken through transfers to households and through tax offsets on transport. The transfers are mainly motivated on equity grounds, and specifically to offset the regressive income effect that the introduction of emissions trading can have through various channels (such as higher electricity prices).

1.15 **The proposals for emission-intensive, trade exposed (EITE) industries** differ significantly from other approaches to managing transitional issues. The method of permit allocation, which is tied to production and linked to an emissions intensity benchmark has strong affinities with the intensity-based approach discussed below. The main difference, as we shall see, is that while with normal intensity-based

[3] Parliamentary Library Vital Issues Seminar, "*Carbon tax and emissions trading"*, 17 March 2009, audio available at: http://www.aph.gov.au/library/pubs/vis/index.htm

approaches, activities receive a net subsidy to the extent that they emit lower than a specified benchmark, under the EITES proposals activities will receive shielding (i.e. an implicit production subsidy) to the extent that their emissions intensity exceeds a certain benchmark. It is important to emphasise that under a cap and trade scheme, attempts to address competitiveness issues and carbon leakage by shielding firms from the cost of emissions must necessarily take the form of either a cash subsidy tied to production or a free permit allocation tied to production. An approach based on the former was recommended by Professor Garnaut, while the CPRS chose the latter route. Some of the drawbacks with the particular approach chosen by the CPRS are discussed below, but at this juncture the important point to note is that the proposals for the EITES involve a scheme that runs along qualitatively different lines to the central cap and trade mechanism.

1.16 The CPRS also includes as yet undeveloped proposals regarding **energy efficiency.** This is almost certainly likely to mirror "white certificate" schemes elsewhere and follow a baseline and credit approach, which again is substantially different to the cap and trade mechanism contemplated for the emissions trading proper.

1.17 Though not part of the CPRS itself, the proposed **MRET** will also follow a baseline and credit approach, in keeping with green certificate schemes found in other jurisdictions.

Commentary on the complexity of the CPRS

1.18 The CPRS is therefore a complex assemblage of different mechanisms. To some extent, all proposals for carbon reduction in a small open economy like Australia will have a degree of complexity. This simply stems from the wider, global context in which such schemes are implemented. Inevitably, reconciling the imperative for credible early action and domestic policy sustainability – through the management of adjustment issues – leads to multiple policy concerns and hence the need for multiple objectives. This is all the more true if the core of the reduction scheme is a particularly high cost proposal, as embodied by the CPRS. The critique that may be offered of the CPRS is that it selects instruments that are ill suited to the

wider policy context in which they are implemented, and to managing the policy concerns that stem from this.

Drawbacks of the CPRS vis a vis objectives sought

Environmental objectives

1.19 The CPRS does not perform well even on the one issue where it is often touted as having a clear advantage over other approaches – namely in providing certainty in the quantity of emissions reduction. For reasons already explained, the various safety valves included in the scheme preclude it from offering such certainty; or at least, what certainty there is exists only up to a certain point in circumstances when the demand for abatement exceeds projections. In this respect, the cap and trade proposal is not substantially different to an intensity-based approach or a tax, both of which allow for flexibility in emissions if the demand for abatement exceeds projections.

1.20 Moreover, the flexibility in the quantity of abatement under the CPRS is asymmetric – the cap loosens after a certain point on the upside when demand for abatement exceeds projections, but does not tighten if the demand for abatement undershoots projections (due to lower than expected emissions growth resulting, for instance, from economic growth that is lower than trend levels or because of unanticipated abatement having taken place e.g. through household initiatives). This is the much publicised issue of "additionality" that has been given a considerable degree of attention, and which means that under the current CPRS, the billions of dollars injected into funding insulation would lead to no additional abatement, but would rather shift the overall contribution made to abatement from large emitters to households (the Government's approach to remedy this is cumbersome and ineffective). The issue of additionality is not unique to the CPRS, but arises in all cap and trade schemes where targets are weak Indeed, this has led to calls for governments to intervene by putting a floor on carbon prices through periodic revisions of the overall cap – a form of intervention that is tantamount to converting the scheme into an intensity-based approach.

1.21 In contrast to the CPRS proposal, intensity-based measures and carbon taxes lead to a tightening of the cap when emissions undershoot expectations. This allows

for a greater degree of smoothness in the carbon price which in turn will provide a better basis for investment decisions including green industries and cleaner energy production. Indeed, the CPRS seems to have captured the worst of all worlds: it is a high costs scheme that, in attempting to contain those costs does away with the feature (certainty in reductions) touted as its greatest asset. Moreover, the asymmetrical nature of this modification removes any possibility of additionality abatement, a feature that has prompted calls for governments to intervene through target revisions.

EITES

1.22 There are several drawbacks to the approach used to handle EITES. Generally speaking, the Government is correct to avoid using border measures such as tariffs and border tax adjustments, as these would be complex to administer, inefficient, and almost certainly in contravention of global trade rules. The use of production subsidies would also be litigious from a WTO perspective to the extent that they are specific to certain firms and contingent on export performance and/or on the use of domestic inputs. The CPRS has got around that problem, on paper at least, by making its system of subsidies ("shielding") contingent on emissions intensity but this in turn raises other problems.

1.23 For a start, the granting of subsidies subject to whether an activity is in excess of a certain emissions threshold is perverse from an abatement viewpoint. Granted, the CPRS legislation does away with the problem that might have existed under the Green Paper proposals, namely that firms might be penalised if they cut emissions because they would drop below the threshold at which shielding was triggered. However, the proposals still mean that those firms that have been relatively efficient prior to the cut off date for measuring the emissions intensity thresholds are not rewarded for their efforts, which can have adverse dynamic efficiency consequences going forward.

1.24 A second issue is that the decision to selectively shield more emissions intensive firms or activities increases pressure on those less intensive trade exposed ones that are not shielded. This is not simply because they do not receive the financial benefit subsidies. A more fundamental issue is that for these firms, the shielding approach acts very much like a real exchange rate appreciation that is imposed specifically on them.

1.25 To see this, consider that the introduction of a price on carbon will inevitably increase the price of non-tradables relative to tradables (that is, the real exchange rate will appreciate). This is because tradable sectors are able to pass on the costs of the carbon price to a much greater extent than non-tradables given that the latter are essentially price takers. The introduction of shielding essentially carves out a sector of the tradables sector – the more emissions intensive – and protects them from the effects of this appreciation. But this simply means that the competitive impact of the price of carbon will fall more heavily on less emissions intensive activities. In particular, there will tend to be a shift in resources and factors of production away from these sectors to shielded sectors and to non-tradables. In this manner, the shielding approach is as much a tax on less emissions intensive activities as it is a subsidy to the more emissions intensive ones.

1.26 In effect, this creates disincentives for resource allocation towards activities that should on balance be promoted. Moreover, it is entirely possible that the disadvantaged sectors will seek relief through other avenues of policy, such as trade policy. This in turn can create further distortions that accentuate economic costs, and create trade tensions that pose an obstacle to securing the type of co-operation required to sustain a global agreement on climate change mitigation.

Governance issues

1.27 The administration of adjustment assistance through transfers, and more generally, the administration of permit revenues, raise a number of governance issues. For a start, the fact that revenues are required to mitigate the regressive impacts of the scheme on income distribution means that at least some of the double dividend (which could have been reaped through the use of permit revenue to cut distortionary taxes on labour and investment) will be foregone. Secondly, the administration of such transfers in a manner that does not affect consumption decisions is likely to be, at the least, problematic. A more general issue is that the large amounts of cash that will transit through government coffers raise all manner of possibilities for wasteful recycling. The modelling of scheme effects implicitly assumed that all recycling is done perfectly efficiently, and without creating any costs through distortions. This is unlikely to be the case. Indeed, experiences with government spending over the last few years suggest that governments are particularly bad at identifying socially optimal forms of spending.

Summary observations on the CPRS

1.28 In sum, the CPRS as it stands is ill equipped to initiate sustainable domestic reform in the realm of climate change policy. In particular, it presents a high cost approach to reform that creates various transitional adjustment issues. These have not been fully addressed in the economic modelling, and to the extent that they have been countenanced, have led to a variety of adjunct measures that (i) undermine the scheme's own aspirations to provide certainty in emissions reductions (ii) add various layers of complexity, notably through approaches to EITES and the recycling of auction revenues, that are conducive to serious economic distortions and problematic governance issues.

1.29 There is significant scope to build on the work done to date and improve the current design of the scheme.

Alternative approaches – an intensity-based approach

1.30 There are various types of scheme architecture that could be proposed as an alternative to the CPRS. While it is tempting to suggest that work on the design of a carbon reduction programme should recommence from scratch, pragmatism suggests that alternatives should build on work that has been done to date, and adapt existing proposals as far as possible.

Mechanics of an intensity-based approach

1.31 The approach proposed is termed an intensity-based approach, as it involves determining, for a particular activity or sector, an emission intensity baseline. Baselines across sector and activities in an economy are set at the level that achieves the desired emissions level. Any producer emitting more than the baseline has to acquire permits in excess of the baseline. Any producer emitting below the baseline is allowed to create and sell permits to those who need to buy permits. The revenue that low emitters earn can help pay for investing in low emission technology. The scheme works by simultaneously penalising higher emitters (just as occurs under a cap and trade) and rewarding lower emitters. In simple terms the scheme is a 'carrots' and 'sticks' approach.

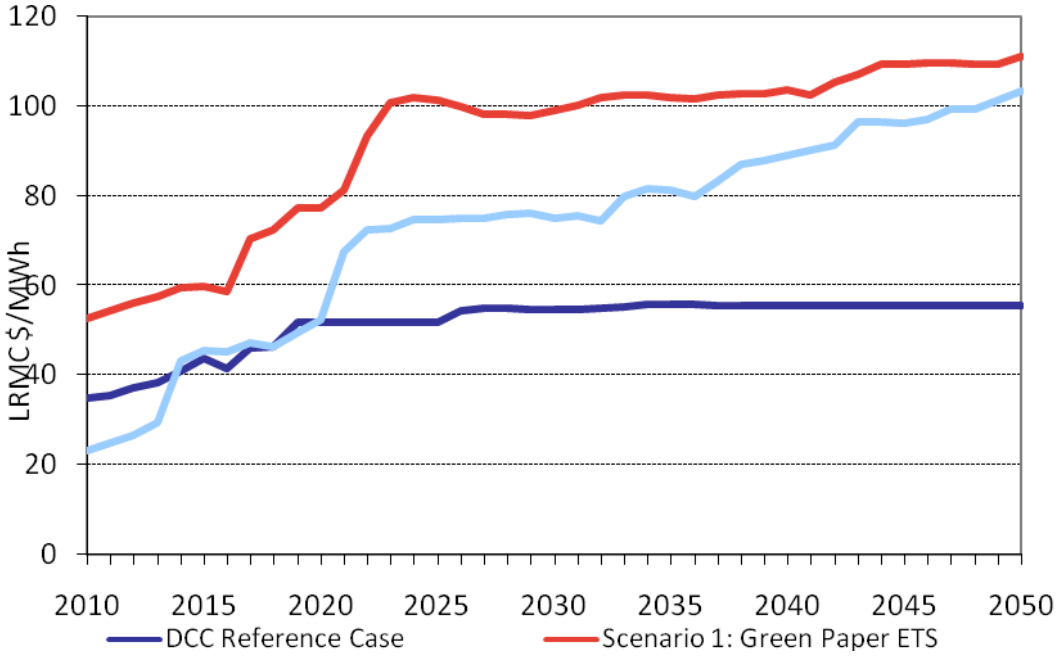
1.32 Conceptually, the scheme has similarities and differences with the cap and trade approach proposed by the CPRS. A cap and trade approach is in effect an intensity approach with an emissions baseline set at zero. This effectively entails an impost on all emissions. A higher baseline raises the threshold at which the cost impost sets in. Changing the threshold does not affect the extent to which high emitters are taxed relative to low emitters – rather, it simply means that the latter receive a net subsidy while the former face a net tax. What has changed is that the absolute level of cost impost is confined to the portion of emissions above the baseline. This in turn means that the absolute price effects of the intensity-based scheme are lower than under cap and trade. A cap and trade scheme could in theory achieve the same result by auctioning permits and then recycling revenue as a flat subsidy to producers. But this would involve the governance complexities of hauling revenue into the Treasury and out again, and the potential for capture that could arise as a consequence.

1.33 As already noted, the CPRS does indeed employ a variant of an intensity-based approach in its proposals for EITIs and shielding. Permits are allocated on the basis of output and subject to an emissions baseline. The main difference, however, is that subsidies kick in once the baseline is *exceeded*. Under the alternative intensity-based approach, the idea would be to create incentives to reduce emissions below the baseline.

Outcomes of this approach

1.34 One of the consequences of confining the cost impost to the proportion of emissions above the baseline is that it reduces the overall price impact of the scheme. Figure 1 (below) provides an overview of the relative price effects of this approach as compared to a cap and trade approach when applied to the electricity sector.

Figure 1:



1.35 The lower price effect is an important result as it deals with the principal adjustment concerns associated with the implementation of emissions trading: competitiveness effects, carbon leakage and regressive income effects. It also deals with these issues in a better and more systematic way than the proposals contained in the CPRS since:

- whereas the CPRS relies on developing a particular type of scheme for EITES to run in parallel with the cap and trade mechanism, the intensity approach would apply across the board to the economy;
- the intensity approach couples lower price impacts with incentives for producers to reduce emissions;
- whereas the CPRS proposals involve a large degree of revenue recycling to address adjustment issues, this approach internalises such transfers within the scheme.

1.36 One question that frequently arises concerns the impact of lower prices on impacts for abatement. In this context, it is important to distinguish between incentives on the supply side versus those on the demand side. On the supply side, incentives for substitution from high to low emissions technologies are preserved since what matters for substitution is the extent to which high emissions activities are taxed relative to low emissions ones. While the absolute value of the impost has decreased, in relative terms high emissions activities are still taxed relative to low emissions ones in the same manner as under cap and trade. The lower level of the absolute impost on producers is what mitigates adjustment issues – particularly for trade exposed activities where firms are price takers. The relativities in net taxation between high and low emissions activities is what sustains incentives to abate.

1.37 Concerns on the demand side are largely related to the effects of lower prices on energy consumption, and hence emissions. In response to this, it should be noted that for a start, demand response may well be muted under existing compensation arrangements for households, in which case the impact of the intensity-based approach would not be materially different to the CPRS proposals (though, as emphasised before, the revenue recycling associated with the CPRS would be avoided). Secondly, existing evidence suggests that demand side abatement is not particularly responsive to price signals.

1.38 There are a large number of abatement options that households could currently adopt on a "no-regrets" basis but that are not taken up, suggesting that other market failures are at work rather than the absence of a carbon cost in the price of energy. If so, a better approach to demand side abatement would be to rely less on the price signals dropping out of emissions trading, and more on a specific demand side abatement scheme, which would address underlying causes of market failure such as split incentives. Indeed, the CPRS proposals allude to the development of such approaches in respect of energy efficiency.

1.39 Demand side abatement schemes typically function as intensity-based approaches, and would therefore be a much more logical and natural extension of the intensity-based approach proposed here than it would be of the CPRS (to which it would be yet another adjunct mechanism).

Attaining abatement objectives

1.40 We already observed that the sum of the emissions baselines across the economy yields the overall reduction target that could be achieved. One issue that is frequently raised is that an intensity-based approach does not guarantee a fixed level of abatement – the worry is that if emissions grow faster than expected (say, because economic growth exceeds projections) then there is no quantitative mechanism that will force emissions back to the absolute target level as would happen under a cap. In theory, this is a valid criticism that could also be levelled at a tax. In practice, it is of little value since it presupposes that the alternative to the intensity-based scheme is an absolute cap. However, as observed earlier, this is not what is contemplated in the CPRS. There will be a variety of safety valve mechanisms that ensure that the cap is not a hard and fast one. The existence of these safety valves is in part a recognition of the higher cost impact of the cap and trade scheme.

1.41 Moreover, this criticism is turned on its head if we consider the opposite case in which emissions grow less fast than expected. Here, the cap implied by the intensity-based approach tightens. One implication of this is that the concerns regarding additionality raised in connection with the CPRS do not apply to an intensity-based approach. Another is that if there is a slump in economic growth, permit prices will not collapse as they would under cap and trade.

1.42 More generally, an intensity-based approach makes for less volatility in permit prices than the cap and trade approach, a point emphasised by Dr Frank Jotzo in his evidence before the Senate Standing Committee on Economics.[4] Smoothing volatility is desirable from an investment point of view.

1.43 To sum up, there is no reason to believe that the proposed intensity-based approach would fare any worse than the CPRS in confining emissions growth to a set target. Clearly, if the CPRS were to be amended to get rid of its safety valves then it would perform better in terms of abatement certainty, but this is unlikely to be adopted given the need for such safety valves to manage the adjustment issues created by the high cost nature of the CPRS. Moreover, the intensity-based approach fares better in managing these adjustment issues (on account of its lower price impacts), in

[4] Dr Frank Jotzo, *Proof Committee Hansard*,Exposure drafts of the legislation to implement the Carbon Pollution Reduction Scheme, 19 March 2009, p 36.

addressing additionality issues, and in managing carbon cost volatility. Because it is better at managing adjustment issue, it also offers the prospect of setting stronger targets than the ones proposed to date.

Implementing the intensity-based approach

1.44 Clearly, the central challenge in implementing an intensity-based approach lies in setting the different baselines. One option would be a linear reduction from historical levels. Under this approach, a sector or particular sub-sector would be subject to the same percentage reduction per year. This is the approach that is essentially adopted by the CPRS in respect of EITIs, though under the new approach this would be implemented across the board and not as part of a shielding package for activities that exceed an emissions intensity benchmark. The advantage of doing this is that it draws on information (carbon accounting) that will need to be collected as part of any scheme and applies a straightforward rule for abatement.

1.45 Another option is to set initial baselines according to world's best practice, and then specify a schedule of cuts thereafter either on a linear basis or on a view of expected abatement opportunities. The advantage of this is that it recognizes the scope for abatement. The disadvantage is that governments will typically be limited in their knowledge of expected abatement opportunities, and firms can take advantage of this asymmetry for rent seeking purposes.

1.46 There is also an option of setting a zero baseline for some sectors, which in effect means a reversion to a cap and trade scheme. Indeed, over time, as cuts are implemented to the baseline, the intensity-based approach will converge to the cap and trade approach. One way of looking at this is to suggest that the intensity-based approach will be used to manage the transitional adjustment issues associated with the introduction of emissions trading and, as these issues diminish (for example, as the participation of other countries in a cooperative solution is secured) the baselines can be phased down so that the intensity-based approach converges on a cap and trade approach. In effect, the intensity-based approach can be characterised as a "transition and convergence" approach.

Governance concerns

1.47 Intensity-based approaches are sometimes criticised on the grounds that they pose various governance challenges in terms of administrative requirements and

dangers from rent seeking. In response, it is important to note that all schemes are exposed to these, and that the CPRS proposals are particularly exposed to such concerns because of the plethora of adjunct instruments that are required to manage the adjustment costs associated with the scheme (to which must also be added the risk that the adjustment costs could spill over into governance challenges for other areas of policy such as trade policy).

1.48 Specifically in relation to the intensity-based scheme, it should be noted that the informational base required to run it is similar to the one required for the CPRS. Both require and draw on information drawn from firms' carbon accounting. Under the intensity-based approach, it would be necessary to guard against efforts to secure baselines that are too generous and that allow unwarranted gains for producers that perform better than baselines. One can address this challenge by drawing on a range of objective measures such as existing emissions levels, and agreed indicators of world's best practice.

1.49 In setting the baselines, it would also be necessary to take into account not only how resources are allocated within particular activities, but also how the baselines across the economy affect resource allocation across sectors and activities. This would require some form of modelling. While this is a demanding exercise, it is no more demanding than (properly) modelling the impacts of any other type of scheme.

Responses to critiques of the baseline and credit and intensity-based schemes

1.50 This note sets out the main criticisms that have been made of the intensity-based approach, and the responses to them.

1.51 The intensity-based approach creates a misallocation of resources by diverting a country's resources from high polluters in a low-emissions industry to low-emitters in a high pollution industry.

1.52 The underlying argument is that the CPRS sends a price signal to consumers: this encourages both supply side abatement (i.e. switching production from high to low emitters within a sector) and demand side abatement (i.e. switching consumption from high emitting *sectors* to low emitting *sectors*, where the end products are substitutes). It is argued the intensity-based allocation targets the former but not the

latter: it mutes price effects and therefore discourages substitution away from high emissions activities to low emissions activities.

1.53 The above is an academic criticism that is of little practical consequence.

- Opportunities for demand side abatement (or substitution of goods) are very limited, are generally not very responsive to price signals, and (where applicable) are more feasible in the long run;
- The (limited) examples of sectors that may be substitutes are trade exposed, hence a price signal is not feasible anyway (i.e. Australia is a price taker in global markets);
- The muting of the price signal is only transitional: over time the baselines for each sector fall and the effects of the scheme becomes more like cap and trade in the long run.

1.54 In practice, the criticism that intensity-based approaches lead to a serious misallocation of resources is overblown because it overstates the importance attached to abatement through demand side responses, and understates the problems that arise from trade exposure.

1.55 On the demand side front, the empirical evidence suggests that the most significant abatement opportunities for Australia are not primarily a function of demand side responses to product market prices. The McKinsey research into abatement cost curves shows a significant number of negative cost abatement options; the fact that these are not exercised at present suggests that there are market failures at work that are unlikely to be addressed by price signals, but would be more likely addressed by specific demand side programs. Moreover, the Government's own estimates of demand side abatement are based on a flawed calculus. Its modelling attributes approximately 120Mt of abatement to demand side response in the electricity sector in 2050. This result overstates the benefits of demand side reduction since they incorrectly use current emissions intensity of electricity of around 1tCO2/MWh to calculate emissions avoided from a reduction in MWh consumed. This is inconsistent with their own modelling results, since the emissions intensity of the market is around 0.1tCO2/MWh by 2050. This means that emissions avoided through demand side abatement would be 1/10 of what they suggest.

1.56 The issue of trade exposure is important since that has a material impact on how carbon pricing affects product market pricing. To see this, consider the case where you have one trade exposed sector such as a smelter and another manufacturer that is not trade exposed and less emissions intensive. Assume that the smelter is trade exposed and is a price taker in the world market, but that the other manufacturer is not, then any carbon price effects on the smelter would translate into an increase in imports and a substitution away from the goods produced by the other manufacturing industry. The higher the price the stronger the effect. This simply points to the risks associated with carbon leakage and the potential distortions that could arise by implementing a cap and trade scheme in a world where not everyone undertakes reduction commitments.

1.57 To sum up, while the price effects of the intensity-based approach have the potential to cause some distortions, they are unlikely to be severe. This could be tested through modelling. Moreover, the costs of those distortions that do arise need to be set against the costs of managing carbon leakage and the distortions this creates; the critique of intensity-based approaches set out above is essentially one-sided since it neglects the benefits side of the ledger. Moreover, because the intensity-based approach converges over time to a cap and trade outcome as baselines are cut, the initial distortions will diminish over time.

Intensity-based approaches are difficult to administer because the baselines are difficult to establish

1.58 There are a variety of ways of setting the relevant baseline. One would be to adopt some best practice base. The other would be to introduce linear cuts to emissions intensity over time. The latter approach has been suggested, for example, in New Zealand in regard to its proposed allocation for agriculture (which follows an intensity-based approach). If one were to adopt a linear cut approach, then the essential requirements are historical – actual emissions intensity and production data. This is not fundamentally different as a requirement from what is needed to run a cap and trade scheme, particularly a cap and trade scheme that also has an emissions intensity-based scheme appended to it (as is the case with CPRS, given that the approach followed in regard to trade exposed sectors is an output based allocation system).

1.59 More generally, this criticism reveals a fundamental misunderstanding of the complexities involved in running a cap and trade scheme in a context where competitiveness effects, carbon leakage effects and adjustment effects need to be managed. If these issues are to be addressed, complexities will inevitably arise in developing mechanisms that determine which producers are eligible for assistance on account of trade exposure and how much, or in developing mechanisms that address household adjustment effects.

1.60 This is abundantly illustrated by the CPRS, which has had to introduce a number of additional mechanisms (such as specific scheme for EITE sectors) to manage these adverse economic effects. These additional mechanisms are a direct function of the high cost impacts of the CPRS on a small open economy – one that is avoided under the intensity-based approach.

1.61 The appropriate comparison is therefore to compare the complexities of administering an intensity-based approach with the complexities involved in running a cap and trade scheme and all the add ons that are necessary to make such a scheme workable. It is somewhat disingenuous to dismiss the intensity-based approach as complex when the scheme currently on the table is one of Byzantine complexity.

Intensity-based approaches are susceptible to rent seeking

1.62 There is no principled reason as to why the intensity-based approach should be more susceptible to rent seeking and manipulation that any other scheme. Indeed, under a cap and trade scheme, such pressures are likely to emerge as a consequence of the impact such a scheme has on competitiveness and carbon leakage. For example, if the Government (as it has done) attempts to limit assistance to a certain subset of EITES that is likely to lead to those who are excluded to lobby in favour of inclusion. This has been the Government's experience ever since the Green Paper came out. More fundamentally, attempts to manage the trade impacts of the CPRS through approaches that arbitrarily cut off assistance are likely to be costly since they (i) run the risk of resource misallocation and (ii) increase the incentives for lobbying.

1.63 More insidiously, the price effects of a cap and trade scheme are likely to increase pressure on other areas of policy – notably trade policy. Pressures for protectionist trade policies are always on the increase globally in times of recession, and adding the cost impacts of a cap and trade scheme will only make matters worse.

Intensity-based delivers less certain abatement

1.64 While intensity-based approaches allow for more flex in the target if actual emissions diverge from projected ones, deviations would be expected to balance out over time as the emissions intensity of the economy falls (hence the link between emissions and growth becomes marginal).

1.65 Moreover, unlike to CPRS, the intensity-based approach can accommodate additional and unexpected abatement by tightening the implied cap. For example, voluntary abatement would be effective under this scheme (as opposed to simply easing the burden on other sectors under the CPRS).

1.66 A more fundamental issue is that this critique implies that the CPRS will deliver certainty in abatement. It will not. As they stand, the CPRS proposes an administered price for the first year, followed by the introduction of a price ceiling in subsequent years. This effectively says that the government is prepared to deliver abatement, but only up to a particular cost threshold. Even then, there is a heavy reliance on permit imports to meet Australia's target, so there is no certainty over domestic emissions in any case. The notion that the CPRS would deliver greater certainty in abatement is repeatedly propounded furphy.

Intensity-based approaches are not viable in an international context

1.67 The idea that a cap and trade scheme is viable in an international context but an intensity approach is not is largely predicated on the notion that the former will deliver certainty in abatement. As already indicated, this is largely an illusion, given the inclination to use safety mechanisms such as price caps in the CPRS. Secondly, even if that issue were to be set aside, the fact is that worries about the competitiveness effects of emissions trading (which are aggravated under a cap and trade scheme) have led major developed emitters to water down their targeted reductions. Thus, even if a cap and trade were to deliver more certainty, this has come at the expense of environmental outcomes. Low targets have become the antidote to poor emissions scheme design. These low targets have, and will continue to, make it difficult to secure international agreement on emission reduction schemes.

1.68 Fundamentally, the choice under a cap and trade scheme is between targets that are high but cannot be sustained, or between targets that can be sustained but are not meaningful. Consequently, there is no intrinsic value or requirement in pursuing a

cap and trade scheme from an international perspective. On the other hand, because the intensity-based approach handles the main adjustment issues related to leakage and competitiveness more efficiently, it offers the scope for pursuing tougher targets, which enhances the chances of securing international agreement. Moreover, given that the scheme has attractive properties for economies like China and India, successfully modelling its implementation can be beneficial to drawing these countries on board.

Canada's decision to abandon the scheme means it has no relevance to Australia

1.69 Canada's decision to harmonise its scheme with that of the US is logical given that Canada's trade is dominated by the US, and so there are gains to it from close integration with the US. If anything, the decision illustrates the importance of choosing a scheme that is appropriate for a particular context.

1.70 The notion that the intensity-based approach is consigned to the "dustbin of history" is fanciful and not supported by the facts. As a matter of practice, if one looks at countries considering emissions trading, many have incorporated intensity-based proposals to some extent in their approach. The CPRS proposes an intensity-based approach in addressing the issue of EITES; New Zealand has proposed an intensity-based approach in respect of agriculture; the EU proposes an intensity-based approach to deal with sector such as aluminium and cement, both in its own scheme and in the context of international sector agreements; Switzerland and Japan have proposed intensity-based approaches.

1.71 The issue is not that intensity-based approaches have lost their relevance. The issue is more that countries such as Australia have proposed a piecemeal approach that combines cap and trade with intensity-based measures, which is costly and distortive. What proponents of intensity-based approaches suggest is to adopt an intensity-based approach on a systematic basis, on the grounds that it can better handle the transitional adjustment issues, and progress over time toward a cap and trade scheme.

Reduction, Adaptation & Mitigation

1.72 Much of the policy discussion surrounding climate change has focused on reducing greenhouse gas emissions, which is understandable given the imperative of

stabilizing atmospheric concentrations of CO2. However, policies that help societies to adapt to the effects of climate change are also a vital part of the story. Both the Stern Review and Professor Garnaut's review devote important chapters to the issue of adaptation. By contrast, the topic has generally been neglected by the Federal Government – there is no mention of it in either the Green or White Papers.

1.73 The adaptation story is vital for two reasons. One is that a lot of climate change is already locked in through the accumulation of GHGs in the atmosphere. We are already seeing some evidence globally of changed weather patterns. Consequently, even under the most optimistic assumptions about reduction, we will experience climate change impacts over the coming years and decades. We thus have an adaptation issue in the short to medium term.

1.74 Secondly, even assuming a global agreement on reduction that makes significant cuts to GHGs, there will still be some residual climate change, given that it is almost inevitable that sea temperatures will rise by 2 degrees. This creates an adaptation issue in the longer run.

1.75 Climate change impacts have the potential to affect a wide range of activities and assets, from ecosystems to agriculture, to housing and human health. Australia is particularly vulnerable to climate change given, amongst other things, the fragility of a number of its ecosystems, its comparative advantage in international trade in agriculture, and the proportion of its population that live in low lying coastal areas. Absent adaptation, climate change is likely to cause severe stress to Australian society, its economy and the environment.

1.76 One of the important aspects of adaptation policy is that people and businesses are quite capable of developing adaptive responses. Farmers, for example, have a long track record of adapting to changing conditions. But that is not a justification for policy neglect. Individuals and businesses need information to make decisions, and consequently there is a need for research and development, as well as the dissemination of information. Sometimes individuals and businesses do not make decisions that are the most beneficial for society as a whole since they do not see the rewards from making those decisions (or the costs of not doing so). And some individuals, notably the aged, the sick and the poor, have a diminished capacity to adapt. So there is a role for government to step in. Finally, government itself can be the main culprit through badly designed policies. For example, if water resources are

not properly allocated or priced, then the damages from climate change will be greater. There is likely to be considerable scope for government policy action that delivers a win on adaptation as well as other environmental and resource management grounds.

1.77 So there is no question that a reasoned approach to adaptation is required. Thus far, whatever thinking there has been on adaptation has largely been undertaken at the state level. While that is not wrong in and of itself – since climate change will have particular localized effects – it would also be wrong not to address that challenge at a federal level. An approach where reduction is tackled federally but adaptation is left to the states can easily perpetuate what Professor Garnaut calls a false dichotomy between the two. Secondly, many adaptation issues cross state boundaries – water management being an obvious example – and consequently will demand a broader approach.

1.78 Further, adaptation won't happen immediately – a lengthy and expensive transition will be required, even if it is pursued with urgency. This will also require the effects of climate change to be managed, or ***mitigated.***

1.79 Since climate change will be accompanied by more extreme weather events such as more severe storms, floods, droughts and coastal erosion, there needs to be a public policy response to mitigate the effects of these inevitable events.

1.80 As this is a national problem it needs to be coordinated at a federal level with adequate resources to ensure a coordinated national approach.

1.81 In summary, there are three essential elements to an effective climate change policy. It must involve an effective reduction target based on a well designed emissions trading scheme that promotes investment certainty on low and zero emissions technologies, taking into account Australia's international competitiveness.

1.82 Further, there must be an integrated adaptation and mitigation policy that best prepares Australia for the inevitable aspects of climate change.

Concluding observations

1.83 One again, it is important to recall what the overarching objective is: to initiate sustainable domestic policy reforms with a view to securing a global co-operative outcome without which domestic efforts will largely be in vain. Meeting this objective requires implementing credible targets and managing adjustment costs effectively. The CPRS does neither. Its approach to managing adjustment issues raises all sorts of governance and policy problems, and the Government tacitly acknowledges the high cost nature of its proposals through the weakness of its target and measures that do away with the oft-touted abatement certainty offered by a cap and trade scheme.

1.84 The intensity-based approach affords a more efficient management of adjustment costs, while preserving abatement incentives. Its implementation can build upon efforts undertaken to date; indeed, over time, it could transition and converge to a cap and trade model as adjustment issues are managed and global cooperation is firmer.

Recommendations

Recommendation 1

1.85 That the Bills not be passed in their current form.

Recommendation 2

1.86 That there be a comprehensive adaptation policy with adequate resources to ensure a coordinated national approach for managing the effects of climate change.

Recommendation 3

1.87 Revising abatement targets upwards to a level that is more likely to secure an effective global agreement on emissions reductions, in order to stabilize atmospheric concentrations of Greenhouse gases at not more than 450 ppm.

Recommendation 4

1.88 That Treasury produce modelling on other types of schemes that have been proposed as alternatives to CPRS, including:

- **a conventional baseline-and-credit scheme;**
- **an intensity model;**
- **a carbon tax;**
- **a consumption-based carbon tax;**
- **the McKibbin hybrid.**

NICK XENOPHON
Independent Senator for South Australia

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Mr Tim Kelly
2	Climate Action Network Australia
3	Alcoa Australia Rolled Products
4	Joe White Maltings (A Division of ABB Grain)
5	UnitingJustice Australia
6	CSR Limited
7	Mr Emil Zyhajlo
8	Ms Carolyn Green
9	Mr Iain Murchland
10	Bureau of Steel Manufacturers of Australia
11	InterGen (Australia) Pty Ltd
12	The Western Australian Farmers Federation (Inc) (WA Farmers)
13	A3P
14	Grain Growers Association and Grains Council of Australia
15	Australian Ethical Investment Limited
16	Nature Conservation Council of NSW
17	Housing Industry Association
18	Leighton Holdings Limited
19	BP Australia Pty Ltd
20	Alcoa of Australia Limited
21	Australian Aluminium Council
22	Griffin Energy
23	Rio Tinto
24	Dr Lance McCarthy
25	Hydro Tasmania
26	ConocoPhillips Australia
27	Caltex
28	Woodside Energy Ltd
29	Minerals Council of Australia
30	Energy Supply Association of Australia
31	Choice
32	Origin Energy
33	Australian Petroleum Production and Exploration Association (APPEA)
34	Carbon Markets Investors Association, Australian Working Group
35	Hillary Morris
36	Taxation Institute of Australia
37	CO2 Group Limited
38	ExxonMobil Australia
39	Australian Industry Greenhouse Network (AIGN)
40	Mr R Barbero

41	Investor Group on Climate Change
42	Voluntary Carbon Markets Association (VCMA)
43	Santos Ltd
44	Australian Coal Association
45	Australian Bankers' Association Inc
46	Australian Financial Markets Association
47	Confidential
48	Confidential
49	Australian Conservation Foundation

Additional Information Received

- Received on 3 June 2009 from the Department of Climate Change. Answers to Questions on Notice taken on notice on Friday, 22 May 2009.

- Received on 1 June 2009 from Treasury. Answers to Questions on Notice taken on notice on Friday, 22 May 2009.

TABLED DOCUMENTS

- **29 May 2009, CANBERRA ACT:**
    - Minerals Council of Australia;

      'The Employment Effects in the Australian Minerals Industry from the Proposed Carbon Pollution Reduction Scheme in Australia' Report
    - Brotherhood of St Laurence;

      'KPMG, Brotherhood of St Laurence and Ecos Corporation
      A national energy efficiency program to assist low-income households' Report

APPENDIX 2

Public Hearing and Witnesses

CANBERRA, FRIDAY 22 MAY 2009

BRADSHAW, Mr Michael, Senior Adviser,
Department of the Treasury

COMLEY, Mr Blair Robert, Deputy Secretary,
Department of Climate Change

DAVIS, Mr Graeme, Manager, Finance Strategy Unit, Business Tax Division,
Department of the Treasury

GARNAUT, Professor Ross Gregory,
Private Capacity

HARRIS, Mr Matt, Consultant,
Frontier Economics

McCREA, Mr Glen James, Manager, Indirect Tax Unit,
Department of the Treasury

MORAN, Dr Alan, Director, Deregulation Unit,
Institute of Public Affairs

PARKER, Ms Cherie Rebecca, Analyst, Investor Protection Unit, Corporations and Financial Services Division, Markets Group, Department of the Treasury

PRICE, Mr Daniel, Managing Director,
Frontier Economics

QUINN, Ms Meghan, Manager, Climate Change Modelling Unit,
Department of the Treasury

SAKELLARIS, Mr Tas, Assistant Secretary, Legislation and Governance Branch,
Department of Climate Change

STERLAND, Mr Barry Keith, First Assistant Secretary, Emissions Trading Division,
Department of Climate Change

TARRANT, Ms Maria, Director, Policy,
Business Council of Australia

CANBERRA, FRIDAY 29 MAY 2009

BURN, Mr Peter, Director, Policy,
Australian Industry Group

CONNOR, Mr John, Chief Executive Officer,
The Climate Institute

FISHER, Dr Brian, Chief Executive Officer,
Concept Economics

HOOKE, Mr Mitchell Harry, Chief Executive Officer,
Minerals Council of Australia

PASCOE, Mr Owen, Climate Change Campaigner,
Australian Conservation Foundation

PEARSON, Mr Brendan, Deputy Chief Executive,
Minerals Council of Australia

SPEDDING, Mr Max, Secretary,
Australian Landfill Owners Association

SULLIVAN, Mr Damian, Manager, Equity in Response to Climate Change Program,
Brotherhood of St Laurence

THWAITES, Mr John, Chairperson, Advisory Group, Equity in Response to Climate Change Program, Brotherhood of St Laurence

TONI, Mr Paul, Program Leader, Sustainable Development,
World Wildlife Fund Australia